United States Senate
WASHINGTON, DC 20510

July 20, 2018

Robert W. Cook
President and Chief Executive Officer
Financial Industry Regulatory Authority
1735 K Street NW
Washington, DC 20006

Dear Mr. Cook:

We write to inquire about your interpretation of the Security and Exchange Commission's (SEC) proposed "Standards of Conduct for Investment Professionals Rulemaking Package," which the SEC released in April and is now open for public comment. Because FINRA serves as the primary regulator of the brokerage industry, your interpretation of the SEC's proposal is critical to understanding how the proposal would affect retail investors. Accordingly, we ask that you provide your views on the proposal promptly so that we and other interested parties can account for those views in any comments we submit to the SEC.

Conflicts of interest in the brokerage industry cost middle-class families dearly.[1] These conflicts are estimated to cost retirement savers alone more than $17 billion per year in lower returns and higher fees than if they had received advice in their best interest.[2]

Congress recognized the problems in the brokerage industry and empowered the SEC to study and address them. Section 913(g) of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act gave the SEC authority to adopt a uniform fiduciary standard for registered investment advisers and broker-dealers.[3] Recognizing that the same loophole exists in the definition of investment advice under the Employee Retirement Income Security Act of 1974 (ERISA), the Department of Labor (DOL) sought to protect retirement savers by exercising its regulatory authority under ERISA to require financial professionals to only provide advice in their clients' best interest.[4] Despite thousands of public comments, hundreds of stakeholder meetings to develop the rule, and DOL's 400-page economic analysis of the rule's impact,[5] a

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[1] Office of Senator Elizabeth Warren, "Villas, Castles, and Vacations (2017 Edition)," February 2017, https://www.warren.senate.gov/files/documents/2017-2-3_Warren_DOL_Rule_Report.pdf.
[2] The White House, Council of Economic Advisers, "The Effects of Conflicted Investment Advice on Retirement Savings," Jason Furman and Betsey Stevenson, February 23, 2015, https://obamawhitehouse.archives.gov/blog/2015/02/23/effects-conflicted-investment-advice-retirement-savings.
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No: 111-203, https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf.
[4] Department of Labor, Employee Benefits Security Administration, Definition of the Term "Fiduciary"; Conflict of interest Rule – Retirement Investment Advice, 81 FR 20945, April 8, 2016, https://www.federalregister.gov/documents/2016/04/08/2016-07924/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice.
[5] Department of Labor, Employee Benefits Security Administration, "Fact Sheet: DOL Finalizes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year,"

federal court recently struck the rule down, and the Trump administration's DOL refused to appeal the decision.[6]

In April, the SEC proposed its own rule, which Chairman Jay Clayton said is meant to "raise[] the standard of conduct for broker-dealers when they provide recommendations to retail investors" and reduce "investor confusion regarding the differences between broker-dealers and investment advisers," among other goals.[7] But despite the explicit direction by Congress in Section 913(g) of Dodd-Frank, the SEC declined to propose a uniform fiduciary standard for broker-dealers and investment advisers.

Instead, the SEC proposed a confusing and ambiguous "Best Interest" standard that it left undefined, but appears to be similar to FINRA's existing suitability standard, which, according to FINRA guidance, already "prohibits a broker from placing his or her interests ahead of the customer's interests" and is clearly insufficient to address harmful conflicts of interest in the brokerage industry.[8] Despite its title implying a much more stringent standard, this proposal is unlikely, for several reasons, to give investors the peace of mind they deserve that the advice they are receiving is truly in their best interests. For example, the proposal does not explicitly prohibit the most egregious sales practices that clearly incentivize brokers to put their own interests ahead of their clients, such as sales quotas and contests.

Absent a private right of action, investors who have been cheated by broker-dealers will have to either rely on the SEC or FINRA to enforce the rule, or file a private claim most likely in FINRA's arbitration forum. This means that FINRA will play a large role in implementing and enforcing the rule. Yet neither Congress nor the public has heard from FINRA about its views on the SEC's proposal.

The SEC's proposed rulemaking package is long, complicated, and, in some important ways, ambiguous. SEC Commissioners themselves disagree about whether it is similar to the DOL rule and "definitely a fiduciary principle," or whether it "essentially maintain[s] the status quo."[9] Whether or not it will fulfill the SEC's stated goal of raising the standard of conduct for

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https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/conflict-of-interest; Department of Labor, Employee Benefits Security Administration, "Regulating Advice Markets, Definition of the Term 'Fiduciary' Conflicts of Interest – Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions," April 2016, https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/ria.pdf.

[6] InvestmentNews, "It's official: DOL fiduciary rule is dead," Mark Schoeff Jr., June 21, 2018, http://www.investmentnews.com/article/20180621/FREE/180629985/its-official-dol-fiduciary-rule-is-dead.

[7] Securities and Exchange Commission, "Overview of the Standards of Conduct for Investment Professionals Rulemaking Package," Chairman Jay Clayton, April 18, 2018, https://www.sec.gov/news/public-statement/clayton-overview-standards-conduct-investment-professionals-rulemaking.

[8] Financial Industry Regulatory Authority, "Suitability: Additional Guidance on FINRA's New Suitability Rule," May 2012, http://www.finra.org/sites/default/files/NoticeDocument/p126431.pdf; Office of Senator Elizabeth Warren, "Villas, Castles, and Vacations (2017 Edition)," February 2017, https://www.warren.senate.gov/files/documents/2017-2-3_Warren_DOL_Rule_Report.pdf.

[9] Securities and Exchange Commission, "Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers," Commissioner Kara M. Stein, April 18, 2018, https://www.sec.gov/news/public-statement/stein-statement-open-meeting-041818.

broker-dealers may depend largely, if not almost entirely, on the way that FINRA interprets the rule and applies it in its disciplinary actions and arbitration proceedings. In other words, billions of dollars in middle-class Americans' hard-earned savings—which families need to buy a house, send a child to college, or retire in old age—may depend on how you understand and implement the SEC's rule.

With that in mind, we ask that you provide answers to the following questions about FINRA's interpretation of the SEC's proposal no later than August 3, 2018.

1. In what specific ways, if any, do you view the proposed rulemaking package as containing different requirements for broker-dealers from those that exist currently, including FINRA's existing suitability obligations found in Rule 2111 and related guidance?[10]

    a. What, if any, specific actions or practices would be required of brokerage firms under the SEC's proposal that are not required currently under your rules?

    b. What, if any, specific actions or practices of brokerage firms would be prohibited under the SEC's proposal that are not prohibited currently?

    c. What, if any, specific changes would you expect brokerage firms to make to their policies and procedures in order to comply with the SEC proposal, if it were finalized in its current form?

2. According to the proposed "Regulation Best Interest," a broker-dealer would be required to "establish, maintain, and enforce written policies and procedures reasonably designed to identify and then to....disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendation." But the proposal does not define the word "mitigate." If it were finalized, how would FINRA interpret the word "mitigate" in this context?

    a. What standard would FINRA use to evaluate whether a conflict of interest must be mitigated, and what standard would FINRA use to evaluate whether a firm's policies and procedures effectively do so?

    b. Do you believe that the SEC's proposal, if finalized, would continue to allow a broker-dealer's financial interests to influence their investment recommendations to any extent?

    c. Please provide several examples of policies and procedures that would and would not sufficiently mitigate conflicts of interest to comply with "Regulation Best Interest."

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[10] Financial Industry Regulatory Authority, "2111. Suitability," http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859.

3. In May, Chairman Clayton stated that while the SEC did not want to use the word "fiduciary" in its proposal, the proposed "Regulation Best Interest" is "definitely a fiduciary principle."[11] He has also stated that "by raising the conduct standard applicable to broker-dealers [this proposal would] apply[] consistent fiduciary principles across the spectrum of investment advice" and that "broker-dealers will be…required to act in the investor' best interests."[12]

    a. Do you believe that the proposed "Regulation Best Interest" would, if finalized, qualify for broker-dealers as "no less stringent" or "the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940," described as within the SEC's authority by Section 913(g) of the Dodd-Frank Act?[13]

    b. Do you believe that the proposed rulemaking package would, if finalized, create similar requirements for broker-dealers as those that applied to retirement accounts in the DOL's 2016 "conflict-of-interest rule"? If so, how? If not, why not?

    c. Do you believe that the SEC's proposal, if finalized, would require that broker-dealers recommend, from available options, the investment product that the broker-dealer reasonably believes to be the best option for the investor? Do you believe that the proposal would, under any circumstances, allow a broker-dealer to recommend anything other than the best option?

4. According to your interpretation of the SEC's proposal, what options would a retail investor have to vindicate the protections included in the rule if he or she were cheated by a noncompliant broker-dealer?

    a. How, if at all, do you believe that the enforcement regime in the SEC's proposal differs from that of FINRA's existing suitability standard?

    b. How, if at all, do you believe it differs from the enforcement regime contemplated under DOL's 2016 "conflict-of-interest rule?"

5. Are there any aspects of the SEC's proposal for which further clarification would help FINRA enforce its requirements? Are there any undefined terms for which a clear definition would help FINRA better understand its enforcement responsibilities in the case that the proposal is finalized? If so, please list them.

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[11] Wealth Management, "SEC's Clayton: "No Daylight" Between Advisor, Broker/Dealer Duties in Proposed Rules," David Armstrong, May 23, 2018, http://www.wealthmanagement.com/regulation-compliance/sec-s-clayton-no-daylight-between-advisor-brokerdealer-duties-proposed-rules.

[12] Securities and Exchange Commissions, "The Evolving Market for Retail Investment Services and Forward-Looking Regulation — Adding Clarity and Investor Protection while Ensuring Access and Choice," Chairman Jay Clayton, May 2, 2018, https://www.sec.gov/news/speech/speech-clayton-2018-05-02.

[13] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No: 111-203, https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf.

6. Has FINRA provided feedback of any kind to the SEC on its proposal? If so, please include copies of those communications in your response. If not, does it plan to?

Thank you for your attention to this important matter.

Sincerely,

Elizabeth Warren
United States Senator

Cory A. Booker
United States Senator

Sherrod Brown
United States Senator