



NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

Report and Findings
of NASAA's
Regulation Best
Interest
Implementation
Committee

National
Examination
Initiative
Phase II (A)

November 2021

REPORT AND FINDINGS OF NASAA’S REGULATION BEST INTEREST IMPLEMENTATION COMMITTEE: National Examination Initiative Phase II (A)

NASAA’s Regulation Best Interest (“Reg BI”) Implementation Committee (the “Committee”) has concluded Phase II (A) of its coordinated national examination initiative. The purpose of this portion of the examination initiative was to collect data regarding broker-dealer policies, procedures, and practices one year after the SEC’s compliance deadline of June 30, 2020 (the “post-BI period”). The Committee has compared this Phase II (A) data with the data collected during Phase I, which reviewed both broker-dealer and investment adviser policies, procedures, and practices in 2018 (the “pre-BI period”). A copy of the Committee’s findings from Phase I can be found here: <https://www.nasaa.org/wp-content/uploads/2020/09/Reg-BI-Phase-1-Report.pdf>.

The information gathered in this national examination initiative provides an early assessment of the efficacy of Reg BI in elevating the broker-dealer conduct standard to one no less stringent than the fiduciary duty applicable to investment advisers. The Phase I and Phase II (A) reports are also intended to inform states as they update their own state regulations, policies, and examination practices in light of the new federal standard.

SURVEY DESIGN AND SAMPLES

Phase I and Phase II (A) of the examination initiative were conducted through the submission of electronic questionnaires issued pursuant to formal examination demands. More than 2,000 firms (over 500 BDs and over 1,500 IAs) responded to requests from securities regulators in 35 jurisdictions. Those states include: AL, AK, AR, CA, CO, CT, DC, DE, FL, GA, IL, IN, KY, LA, MD, MI, MN, MS, MT, NE, NV, NJ, NM, NY, OH, OK, OR, RI, TX, UT, VT, WA, WV, WI, and WY.

The top ten priority areas in the coordinated examination initiative include:

- variations in the types of products sold;
- policies, procedures, and practices (“P&P”) related to the sale of alternative or complex product types, with specific attention to private securities, non-traded real estate investment trusts (“REITs”), leveraged or inverse exchange-traded funds (“ETFs”), and variable annuities;
- P&P regarding sales contests, quotas, bonuses, and extra compensation;
- P&P involving recommendations as to account type and IRA rollovers;
- cost comparison due diligence and disclosure practices;
- P&P involving receipt of third-party compensation and differential compensation;
- P&P regarding disclosure, avoidance, or mitigation of financial incentive conflicts;

- P&P regarding point of sale disclosures;
- customer profile forms and/or suitability questionnaires; and
- use of advisor and adviser title while operating in the capacity of a broker-dealer.

Phase I took a broad snapshot of the entire investment industry in 2018, prior to the SEC’s adoption of Reg BI, to set up industry baselines and to compare the policies, procedures, and practices of FINRA firms operating under the suitability standard with the policies, procedures, and practices of investment advisers operating as fiduciaries. Phase I did not differentiate between broker-dealer business models (e.g., standalone versus dually registered, federal versus state adviser affiliation) for purposes of reporting findings. On the IA side, states focused primarily on state-registered firms. The Phase I report found that most firms on both sides were engaged in the sale of conventional securities like stocks and mutual funds in traditional asset classes like equities and fixed income. FINRA firms offered a more diverse set of product offerings than IAs, but their menu included more complex and high-commission products. Few firms on either side had product-specific policies or used tools to compare investment opportunities.

By contrast, Phase II (A) took a more targeted and in-depth look at FINRA firms in the first year following the SEC’s compliance deadline for Reg BI, as FINRA firms are the ones subject to the new federal conduct standard. The Phase II (A) sample includes a total of 443 firms – 382 firms that submitted responses in Phase I (the “control subgroup”) plus 61 new firms that participating states added to round out their samples.

Within the control subgroup, the Committee focused its review on changes in the Reg BI firms, i.e., FINRA firms providing recommendations to retail customers, because these firms allow direct, apple-to-apple comparison of pre- and post-BI behaviors. This analysis includes 225 FINRA firms that affirmatively recommended securities to retail investors and excludes from the analysis 157 firms that were not subject to Reg BI because they either (a) were not broker-dealer firms or (b) reported that they did not offer or recommend securities to retail customers during the review period. Charts and select findings for these firms can be found in Appendices A and D.

	Number of Firms	Number of Retail Accounts (2021)	Number of Reps (2021)
Control subgroup	382	87 million	327,000
Reg BI (control) subgroup	225	77.6 million	316,000
Reg BI (full sample) CCR subgroup	179	69 million	317,000

This report documents changes made (and not made) in the control subgroup as firms transitioned from the suitability standard to the new best interest standard. Beyond the control subgroup, the report also highlights the Committee’s observations regarding 179 Reg BI firms that recommended one or more of the select complex, costly, risky products (“CCR firms”) analyzed in this exam initiative, namely, private securities, variable annuities, non-traded REITs, and leveraged or inverse ETFs. The CCR firms consist of 173 Reg BI firms from the control subgroup plus 6 additional Reg BI firms examined in Phase II (A). The Committee compared and contrasted responses of the CCR firms with two other populations of firms in the exam dataset: (a) non-CCR firms - 56 Reg BI firms

that did not recommend any of the four CCR product types to retail investors in the first year of implementation (although the products were made available to their brokers for retail use) and (b) fiduciary firms – 1,552 investment adviser only firms examined in Phase I. Findings distinguishing amongst these populations can be found in Appendix B.

EXECUTIVE SUMMARY

***Best Interest Obligation.** A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.¹*

As former NASAA President Christopher Gerold (New Jersey) noted when the Committee launched Phase I of this exam initiative, progress measured is progress made. In Phase II (A), the Committee measured the progress that FINRA firms made in complying with Reg BI's directive to "act in the best interest of the retail customer" without placing their financial interests ahead of the interest of the retail customer. Although the term "best interest" is not defined in the rule, the SEC described the standard as the transactional equivalent of the fiduciary duties of care and loyalty that apply to investment advisers with the primary difference being temporal, *i.e.*, a broker-dealer is required to act in the best interest of its client "at the time of the recommendation," whereas an investment adviser is required to act in the best interest of its client "at all times."

To assess firm progress, the Committee analyzed firm policies, procedures, and practices in the areas of due diligence and care, disclosure, and conflict management, corresponding directly to the core elements or "obligations" of Reg BI. As compared to the conduct reported by these firms in 2018 under the suitability standard, there were slightly more firms engaging in pro-investor best practices and slightly fewer engaging in harmful conflicts. That was a welcome step in the right direction for those firms, but most of the Reg BI firms examined in this initiative have remained fairly stagnant and continue to operate precisely the same under Reg BI as they had under the suitability rule.

Moreover, as compared to the conduct reported by investment advisers in 2018, the slight gains noted by Reg BI firms fall far short of the fiduciary marker. One full year after the compliance deadline, most of the Reg BI firms sampled are not providing fair and balanced point-of-sale disclosure regarding fees, costs, and risk to retail investors. Meanwhile, these Reg BI firms have steadily increased their participation in complex,

¹ Regulation Best Interest, SEC Rel. No. 34-86031, File No. S7-07-18 (Jun. 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

costly, and risky products under the new conduct standard and continue to rely on financial incentives that Reg BI was intended to curb, incentives rarely seen with fiduciary advisers. In short, too many Reg BI firms are still placing their financial interests ahead of their retail customers in violation of the rule’s chief directive. Clearer regulatory guidance is needed to allow a course correction that would help Reg BI earn the “best interest” label that it bears.

PRODUCT OFFERINGS AND RESTRICTIONS

In Phase I, the Committee compared and contrasted the product mix offered by FINRA firms and investment advisers, noting how FINRA firms operating under a suitability standard offered a wider variety of product offerings and how investment advisers operating exclusively under a fiduciary standard tended to steer clear of complex, costly, and risky products. In the run-up to adoption and in the first year of implementation, states heard anecdotally that firms were adjusting their product shelves to limit risk and ease compliance with Reg BI. To ascertain more specifically what changes firms had (or had not) made, the states asked firms directly whether Reg BI caused them to cease sale of any specific product types or, alternatively, caused them to restrict sales of any specific product type based on factors like customer age, income/net worth, or risk profile; special agent certification; compensation adjustment; or elimination of financial incentive conflict.

The overwhelming majority of Reg BI firms stated they did not cease sale of any products (93%) or restrict product sales (76%) as the result of Reg BI. No product type experienced more than a 2% reduction in firm offerings in the control subgroup. With respect to product restrictions, only seven product categories experienced a 5% or greater increase in new sales restrictions after Reg BI. Those product categories included: variable annuities (12%); mutual funds (10%); indexed annuities (8%); unlisted direct participation programs (e.g., non-traded REITs) (7%); private securities (5%); municipal funds and 529 plans (5%); and standard ETFs (5%). These findings suggest that most firms have not materially reformed the due diligence policies and practices that were in place under the suitability standard to more carefully match their retail customers with products under Reg BI. More detailed findings in this area are set forth in the Care Obligation section below.

Reg BI (control subgroup) firms	Ceased making product available for retail use as the result of Reg BI	Restricted product for retail use as the result of Reg BI
Equities	0%	4%
Debt/fixed income	0%	4%
Options	1%	4%
Mutual funds	1%	10%
Variable annuities	0%	12%
Indexed annuities	0%	8%
Municipal funds and 529 plans	0%	5%

Unlisted direct participation programs (non-traded REITs)	1%	7%
Listed REITs	0%	3%
Hedge funds	0%	3%
Standard ETFs/ETNs	0%	5%
Leveraged or inverse ETFs/ETNs	2%	4%
Penny stocks or other thinly-traded securities	2%	4%
Derivatives	1%	1%
Highly-leveraged products	1%	2%
Private securities	1%	5%
Cryptocurrency or other digital assets	1%	2%
Proprietary products	0%	4%
No-load products	1%	3%
Unit investment trusts	0%	3%
Structured products (e.g., market-linked notes, reverse convertibles)	0%	4%
Special-purpose Acquisition Companies (SPACs)	1%	3%
None of the listed products were ceased or restricted for retail use as a result of Reg BI	93%	76%

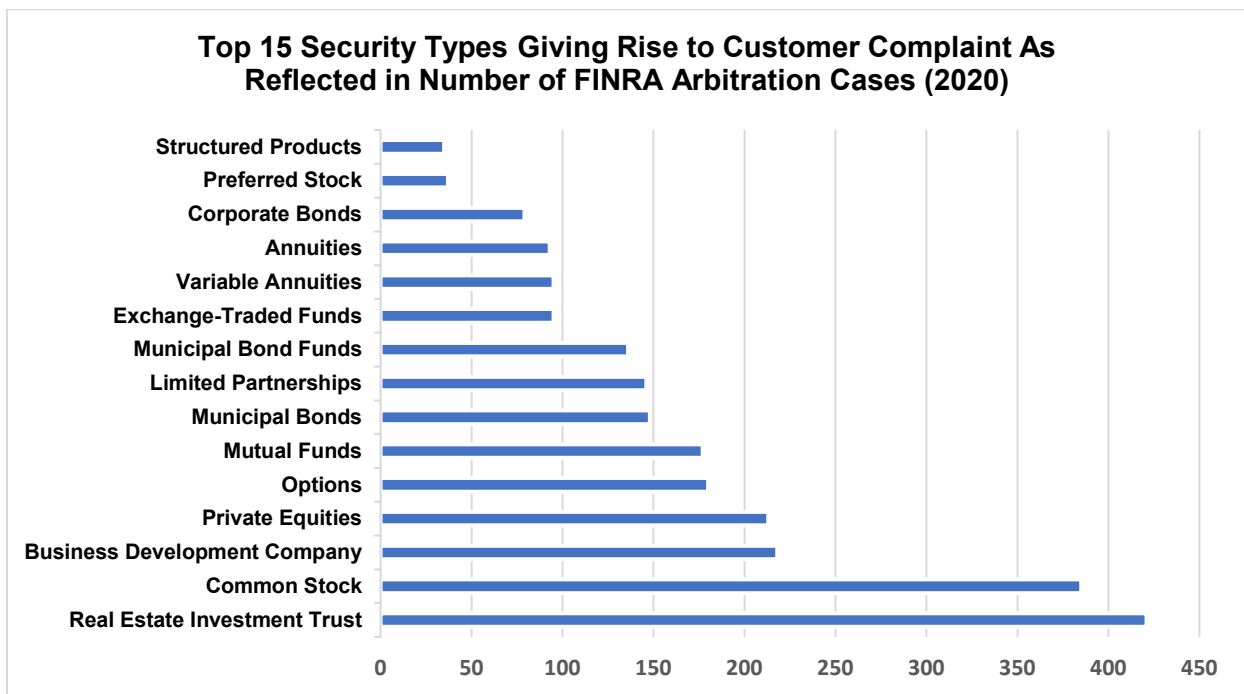
The chart below highlights the products that were most and least commonly offered to retail investors by the sampled Reg BI firms in 2021.

Most Commonly Offered	Least Commonly Offered
1. Mutual Funds (94%)	1. Cryptocurrency (3%)
2. Equities (86%)	2. Highly Leveraged Products (7%)
3. Debt/Fixed Income (82%)	3. Derivatives (12%)
4. Municipal Funds (79%)	4. Hedge Funds (15%)
5. Standard ETFs (76%) and Variable Annuities (76%)	5. Special-Purpose Acquisition Companies (SPACs) (17%)

Several firms supplemented their responses to the Phase II (A) questionnaire with a note explaining they had adopted a variety of product and policy reforms before (rather than a result of) Reg BI because they saw the “writing on the wall” following the Department of Labor’s fiduciary rulemaking. These firms expressed concern that the questionnaire might not adequately account for earlier reforms and, consequently, might not give Reg BI all the credit that it deserves. The Committee advised these firms (and their trade association SIFMA, who echoed this concern on their behalves) that the firms control their responses to the questionnaire and could give credit to Reg BI for earlier reforms made “in the spirit” of Reg BI where they felt that was warranted. The truth is it does not matter what motivated a firm to adopt a pro-investor policy or eliminate a harmful conflict (or when the firm did either of those things) to better serve retail investors. What matters is where those policies and conflicts stand now, a year after the Reg BI compliance deadline. Findings on those fronts are set forth below.

COMPLEX PRODUCTS



A focal point of this exam initiative has been the sale of complex, costly, and risky (“CCR”) products to retail investors. Although there are many investment products that have one or more of these attributes, the examination tool used in Phase I looked specifically at four product types that have all three of these characteristics: private securities, variable annuities, non-traded REITs, and leveraged or inverse ETFs. These products routinely appear in investor complaints and state enforcement actions. The Committee continued to analyze these four product types for Phase II to allow clean comparisons amongst firms during the pre- and post-BI periods and because these product types continue to generate a high number of investor complaints (as evidenced in chart below).²



In Phase II (A), the Committee found more firms participating in these CCR products under Reg BI than under the suitability rule. In 2018, 11% of the Reg BI firms in the control subgroup did not offer any of the four CCR product types analyzed in this exam initiative. In 2021, under Reg BI, all firms offered at least one. Moreover, the percentage of firms offering the following high-risk products rose more than 10% after Reg BI: hedge funds, private securities, cryptocurrency, and structured products.

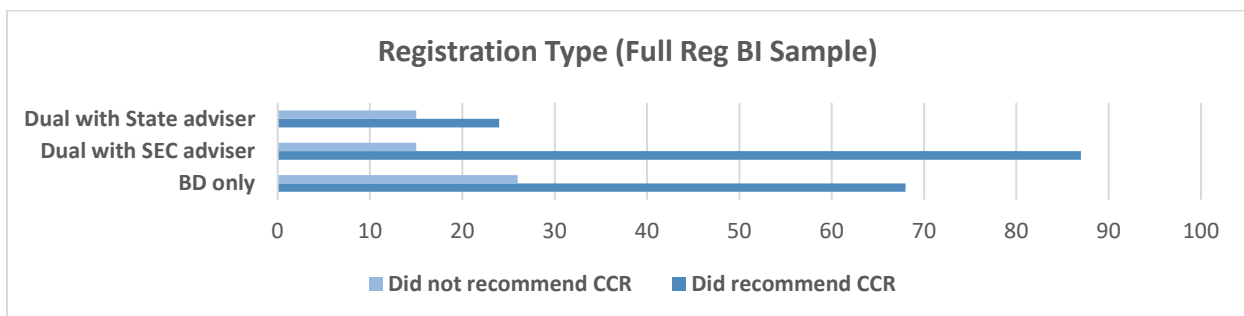
² Data drawn from FINRA Dispute Resolution Statistics, Top 15 Security Types in Customer Arbitrations (2020), <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics/2020#top15securitycustomers>. The four CCR products remain at the top of FINRA’s list in 2021. See FINRA Dispute Resolution Statistics, Top 15 Security Types in Customer Arbitrations (2021), <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#top15securitycustomers>.

Conversely, although CCR products became more widely available in the retail market after Reg BI, firms have recommended them at a reduced rate. In 2018, 11% of the Reg BI firms in the control group abstained from a recommendation involving these products, but that percentage doubled to 23% in 2021. Recommendations for every CCR product type, except private securities, decreased a little after Reg BI. The product restrictions employed by 24% of the Reg BI firms could provide a partial explanation for this shift.

CCR Products (control subgroup)	Pre-BI (2018)	Post-BI (2021)	Availability	Recommendations
Private Securities recommended	26%	28%		
Non-traded REITs recommended	29%	26%		
Leveraged or inverse ETFs recommended	23%	9%		
Variable annuities recommended	68%	67%		
None offered during this time	11%	0%		
None recommended during this time	11%	23%		

An interesting note about the CCR firms is how they break out in terms of registration type. In Phase I, the Committee observed that these products were more likely to be sold by broker-dealers under a suitability standard than investment advisers operating under a fiduciary standard so the Committee was curious how dually registered firms (operating under both standards) might lean. In Phase II (A), the Committee found CCR products more concentrated in broker-dealers dually registered with a federal adviser. Those firms accounted for 48.6% of the CCR subgroup, which exceeded their proportional representation in the control sample by 5%. Standalone broker-dealers accounted for 38% of the CCR subgroup, which was slightly less (1.5%) but proportional to their representation in the full sample. The Committee found less participation in broker-dealers dually registered with a state adviser. Those firms accounted for 13% of the CCR subgroup, which is 4% less than their representation in the full sample. Additional findings regarding CCR firms (based on product recommendation) can be found in Appendix C.

Within registration types, the Committee observed similar trends. Broker-dealers dually registered with an SEC adviser that recommended CCR products outnumbered those that did not by a 6 to 1 ratio, while the ratio for broker-dealers dually registered with a state adviser that recommended these products outnumbered those that did not on a much smaller 1.6 to 1 ratio. Standalone broker-dealers fell in between at a 2.61 to 1 ratio.



When looking more closely at individual product types in Phase II (A), the Committee found variable annuities to be the most popular of the four CCR products in the first year after the Reg BI compliance deadline. Two-thirds (66%) of Reg BI firms recommended them in this timeframe, followed by private securities (29%); non-traded REITs (27%), and leveraged or inverse ETFs (8.5%). Except for leveraged or inverse ETFs, which had roughly equivalent rates of offer and sale, the CCR products were offered and recommended at Reg BI firms many multiples the percentage observed with firms operating under the fiduciary standard, consistent with the findings in the Phase I report.

CCR Products (full sample)	BI (2021)	IA (2018)	
Firms that <i>offered</i> at least one of these products during review period	100%	27%	3x difference
Firms that <i>recommended</i> at least one of these products during review period...	76%	14%	5x difference
... specifically recommended Private Securities	29%	3%	9x difference
... specifically recommended Non-traded REITs	27%	2%	13x difference
... specifically recommended Leveraged or Inverse ETFs	9%	7%	Near 1 to 1
... specifically recommended Variable Annuities	66%	5%	13x difference

CARE OBLIGATION

Under Reg BI, the broker-dealer conduct standard has been elevated to require firms to recommend products that are not only suitable for retail customers, but in retail customers' best interests. To be sure, strong due diligence policies, procedures, and tools are key to meeting Reg BI's new standard of care obligation, as reproduced below.

Care Obligation. The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, and skill to:

- (A) *Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;*
- (B) *Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;*
- (C) *Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when*

viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.

One of the most important due diligence tools that a firm has is the investor profile form. In Phase I, states asked firms a series of questions regarding their use of and specifications for these forms. The Phase I report noted that most firms used investor profile forms and questionnaires, but there was a small percentage that did not. There were also critical bits of customer information omitted in the forms used by many firms.

In Phase II (A), there were still a few Reg BI firms (1%) found not using investor profile forms in making recommendations to retail customers. Virtually all firms that used the forms included the following key metrics: customer age (98%), income (99%), net worth (100%), investment objective (99%), and time horizon (98%). There was regression to minimal improvement shown by the firms in gathering critical data regarding customer education level and debt. Only 21% of the Reg BI firms in the control subgroup asked about education level and only 30% asked about debt in 2021, compared to 22% and 28%, respectively, in 2018. On education level, the Reg BI firms matched the Phase I figures reported for investment advisers (at 21%), but a few of the Reg BI firms stopped asking customers about education level after Reg BI, even though they previously collected the information under the suitability standard. Even with progress made (+3%), Reg BI firms still fell short of the marker left by investment advisers (49%) in collecting customer debt data.

To help firms better steer customers from suitable to best interest recommendations, Reg BI requires firms to consider reasonably available alternatives. Cost and risk are two non-dispositive factors that firms are specifically directed to consider as part of this due diligence requirement. Indeed, this new emphasis on cost was highlighted by the SEC as one of the rule's defining features distinguishing it from the suitability standard. Unfortunately, Reg BI's adopting release does not give firms much guidance on how to operationalize this requirement and the SEC has not followed up with any concrete guidance in FAQs that have been issued in the two years since. In Phase II (A), the states queried firms on four different methods they could use to operationalize the requirement with respect to the factors of cost and risk.

The first way that firms could have operationalized the "consideration of reasonably available alternatives" requirement with respect to cost and risk is by leveraging internal or external cost- and product-comparison tools. The Committee is aware of tools being created after Reg BI's adoption for this very purpose by various RegTech providers. Two-thirds of the firms indicated they used such tools, but almost a third (32%) reported they did not. Absence of these tools is concerning for firms selling more expensive and riskier products. For example, there are lower-cost and lower-risk alternatives readily available for each of the CCR products analyzed in this exam initiative, but 19-30% of the firms reported lacking the tools required to give those alternatives due consideration.

Firms recommending...	Private Securities	Variable Annuities	Non-traded REITs	Leveraged or Inverse ETFs
Lack cost/product comparison tools	30%	19%	19%	20%

A second way that firms could have operationalized this requirement would have been to update their policies, procedures, and training programs to require their brokers to affirmatively offer and discuss less costly, less risky products before they are permitted to recommend the most expensive and riskiest products in the retail market. Nearly all firms (95%) offering the four CCR products examined in this initiative reported use of some product-specific guidelines or training in place to facilitate proper matching, but only about half of those firms are offering or discussing lower-cost or lower-risk alternatives with their customers. This is true even where the lower-cost or lower-risk product is available within the firm. It is hard to see how it would ever be in a customer's best interest for a firm to consider lower-cost and lower-risk products under Reg BI and then hide those options from the customer in order to sell the most expensive, riskiest products. That practice is not only offensive to Reg BI, it is dishonest and unethical, tantamount to fraud.

A third way firms could have operationalized the requirement would have been to restrict sales of select products – for example, the most expensive and riskiest products – to ensure that they are only recommended to customers for whom the products are best suited (and in concentrations that align with risk- and loss-tolerance). As noted above, only 24% of the firms imposed new product restrictions as the result of Reg BI.

To get more detail regarding the restrictions that are in place post-BI, the Committee examined restrictions commonly used to prevent a product mis-match in the highest-risk areas in the retail market – namely, sales to investors who are elderly, retired, unsophisticated, in foreseeable need of liquidity, or simply risk- or loss-adverse. The Committee found that universal adoption of these basic restrictions was lacking in all high-risk areas tested for CCR products sold after Reg BI.

Have no limitations based on ...	Private Securities	Variable Annuities	Non-traded REITs	Leveraged or Inverse ETFs
Age or retirement status	61%	51%	51%	70%
Customer sophistication	34%	64%	46%	65%
Customer liquidity needs	31%	40%	27%	N/A
Customer risk profile	36%	50%	40%	50%

To convert these raw percentages into more relatable investor stakes, the Committee would note that the 36% of firms offering risky private securities with no limitations tied to customer risk profile have over 100,000 representatives and 30 million retail customers. The 40% of firms offering illiquid variable annuities with no liquidity restrictions have over 135,000 representatives and almost 31 million retail customers. The 51% of firms offering non-traded REITs, known to generate elderly investor complaints, without age restrictions have over 141,000 representatives and 33 million retail customers. The 65% of firms offering leveraged or inverse ETFs, which are some of the market's most complex products, without regard to customer sophistication have over 113,000 representatives and 30 million retail customers.

A fourth way that firms could have operationalized the requirement would have been to convert existing suitability questionnaires (to the extent they have them) into new best interest questionnaires that require the broker to consider lower-cost and lower-risk products. The Committee did observe an increase in the percentage of firms using suitability or “best interest” questionnaires (up 12% to 96%), but it is uncertain if and how cost and risk are addressed in those forms. That is an area that the Committee will explore in Phase II (B).

Lastly for this section, the Committee would note that 8% of Reg BI firms (all of which offered at least one of the CCR products) reported having no product-specific policies or procedures to help them comply with the standard of care. It is not clear how these firms are performing their due diligence, but it is another area to explore in Phase II (B).

DISCLOSURE

The next area that the Committee examined in Phase II (A) was what changes, if any, Reg BI firms made to comply with Reg BI’s new disclosure requirements. The Committee was particularly interested in the firms’ point-of-sale disclosure policies and practices because, as noted in Phase I, that is the most important inflection point for retail customers. As such, the states asked firms about transactional disclosure occurring outside of the Form CRS (which does not highlight fees and costs at the transactional level) and the product prospectus (where fees and costs are typically buried in fine print and, absent affirmative broker explanation, are likely unknown or indiscernible to most unsophisticated retail investors). Below is the text of the rule’s new disclosure obligation.

Disclosure Obligation. The broker, dealer, or natural person who is an associated person of a broker or dealer, prior to or at the time of the recommendation, provides the retail customer, in writing, full and fair disclosure of:

- (A) *All material facts relating to the scope and terms of the relationship with the retail customer, including:
 - (i) *that the broker, dealer, or such natural person is acting as a broker, dealer, or an associated person of a broker or dealer with respect to the recommendation;*
 - (ii) *The material fees and costs that apply to the retail customer’s transactions, holdings, and accounts; and*
 - (iii) *The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer; and**
- (B) *All material facts relating to conflicts of interest that are associated with the recommendation.*

As in Phase I, most firms (92%) in Phase II (A) had at least some policies and procedures related to some fee disclosure. Reg BI requires more, of course, demanding firms consider lower-cost and lower-risk products and provide full and fair disclosure of all material fees, costs, and conflicts of interest associated with the recommendation considering those reasonably available alternatives. Based on Phase II (A) data, few Reg BI firms are providing fair and balanced point-of-sale disclosure.

Fewer than a third (31%) of the Reg BI firms made it a policy to affirmatively offer or discuss (outside of the Form CRS or product prospectus) the existence of lower-cost products available *inside* the firm. Only a fifth (19%) affirmatively discussed (outside of the Form CRS or product prospectus) lower-cost options available *outside* the firm. These percentages are roughly 10% higher than the percentages reported under the suitability standard. Clearly, these firms are not disclosing all material facts related to the conflicts associated with their recommendations.

Fortunately, more firms were transparent when recommending complex, costly, and risky products, but still short of a majority. Up to half of the Reg BI firms sampled affirmatively alerted customers to lower-cost and lower-risk alternatives when they recommended private securities, variable annuities, non-traded REITs, and leveraged or inverse ETFs:

Firms recommending...	Private Securities	Variable Annuities	Non-traded REITs	Leveraged or Inverse ETFs
Fail to offer and discuss lower cost alternatives	76%	50%	67%	65%
Fail to offer and discuss lower risk alternatives	76%	54%	70%	60%

Although there are hundreds of different kinds of fees imposed by firms in our markets today, retail customers should know what they are paying up-front such as the commission for each transaction and what they should expect to pay later in the form of ongoing or deferred fees and charges. To figure this out, many customers of CCR firms will have to decipher it from the fine print of a prospectus and the generic disclosures of the Form CRS. With the exception of deferred compensation involving variable annuities, which was disclosed outside of the prospectus and Form CRS by a significant majority (81%) of firms, nearly half of the firms recommending *costly* products failed to disclose at the point-of-sale the amount of compensation they stand to gain in the transaction.

Firms recommending...	Private Securities	Variable Annuities	Non-traded REITs	Leveraged or Inverse ETFs
Fail to disclose outside the prospectus or Form CRS up-front commissions	58%	44%	41%	75%
Fail to disclose outside the prospectus or Form CRS deferred sales charges	66%	19%	49%	--

While the SEC was persuaded, at the time of adoption, that it would be “difficult and costly to calculate with accuracy” individualized disclosure at the point-of-sale, circumstances have changed during implementation. About half of the Reg BI firms in Phase II (A)

voluntarily provided this level of disclosure, suggesting it is neither a lofty nor cost-prohibitive goal. The SEC should clarify and enforce the plain language of the rule so that “material fees and costs that apply to the retail customer’s transactions” are disclosed when it matters most, at the point-of-sale. At a minimum, the SEC should clarify that heightened point-of-sale disclosure is required for higher compensating products, particularly where the recommendation increases risk relative to less costly products. Otherwise, cost is no more important under Reg BI than it was under suitability and Reg BI’s new disclosure obligation is rendered ineffective at best.

CONFLICTS OF INTEREST

The next area that the Committee analyzed in Phase II (A) was what changes, if any, firms made to comply with the new conflict of interest requirements of Reg BI. For the Committee, this was one of the most important parts of the exam initiative as conflicted advice is known to wipe out billions of dollars annually from the retirement accounts of American savers. The text of the rule’s conflict of interest obligation is set forth below.

Conflict of Interest Obligation. The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to:

- (A) Identify and at a minimum disclose, in accordance with subparagraph (a)(2)(i), or eliminate, all conflicts of interest associated with such recommendations;*
- (B) Identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;*
- (C)*
 - (i) Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with subparagraph (a)(2)(i), and*
 - (ii) Prevent such limitations and associated conflicts of interest from causing the broker, dealer, or a natural person who is an associated person of the broker or dealer to make recommendations that place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and*
- (D) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.*

When it comes to conflicts, the key area to examine is compensation. As noted in the proposed and adopting releases for Reg BI, certain compensation practices create strong financial incentives (conflicts) for firms and their agents/ reps to steer their customers into account types, products, or strategies that are more remunerative for the firm or the agent. Sales contests and the receipt of third-party compensation are two compensation practices often discussed in this context. As such, Reg BI expressly prohibited time-sensitive, product-specific sales contests because they cannot be reasonably mitigated but allows time- or product-agnostic contests and third-party compensation to continue, provided there is proper disclosure and mitigation. As a reminder, in 2018, investors were more likely to find these two types of financial incentive conflicts at FINRA firms than IAs.

In Phase II (A), the Committee expected to see significant elimination of financial incentive conflicts by firms in the control subgroup. That was not the case. Only minor reductions in the 0-6% range were observed.

Financial Incentive Conflicts Observed in Control Subgroup	Suitability (2018)	Reg BI (2021)
Product-specific sales contests, quotas, or bonuses to compensate agents/representatives	3%	0.4%
Sales contests, quotas, or bonuses for proprietary product	2%	1%
Sales contests, quotas, or bonuses that are not tied to a specific product	28%	24%
Agent/rep compensation to sales of a proprietary product	7.5%	9%
Third-party compensation beyond commission <i>from product manufacturer or sponsor</i>	31.5%	25%
Third-party compensation beyond commission <i>from another broker-dealer, investment adviser, or other financial institution</i>	24%	20%
Third-party compensation beyond commission <i>from insurance marketing organization</i>	27%	19%
Conference or training program reimbursement by a product manufacturer, related trade association, or insurance marketing organization.	--	54%
Advertisement of "zero commission" trades	5%	4%
Agent/representative compensation to asset accumulation	22%	21%
Agent/representative compensation to incremental sales growth	33%	30%
Incentive/bonus tied to launch of closed-end fund or other time-limited product	1%	1%
Differential compensation within product family or comparable product lines	30%	29%

To see how Reg BI firms stack up against fiduciary firms in this area, the Committee compared key findings from both groups. As set forth below, notwithstanding slight progress made, Reg BI has a long way to go to close the investor protection gap that separates FINRA firms from investment advisers when it comes to reducing harmful financial incentive conflicts.

Financial incentive Conflicts	BI (2018)	BI (2021)	IA (2018)
Participation in product-specific sales contest	3%	0.4%	0%
Participation in product-agnostic sales contest	28%	24%	1%
Receipt of extra compensation beyond commission from product manufacturer	32%	25%	2%
Receipt of extra compensation beyond commission from another financial intermediary	24%	20%	3%
Compensation based on incremental sales growth	33%	30%	3%
Differential compensation	30%	29%	0.5%

Because these findings strike right at the heart of the conflicted advice debate, the Committee examined the Reg BI firms more closely to see what might be holding them back. The Committee knew that financial incentives were commonly used to promote sales of CCR products under the suitability standard and wondered how they were being used by CCR and non-CCR firms after Reg BI. Around a third of the firms in the CCR subgroup reported continued participation in product-agnostic sales contests and the receipt of extra cash (or non-cash compensation) from a product manufacturer or other financial intermediary beyond the commission. Most (64-83%) also accept conference and training reimbursements from product manufacturers and trade associations, something states will be scrutinizing more closely in Phase II (B). Firms selling non-traded REITs showed the highest level of participation in all four of these “extra compensation” categories.

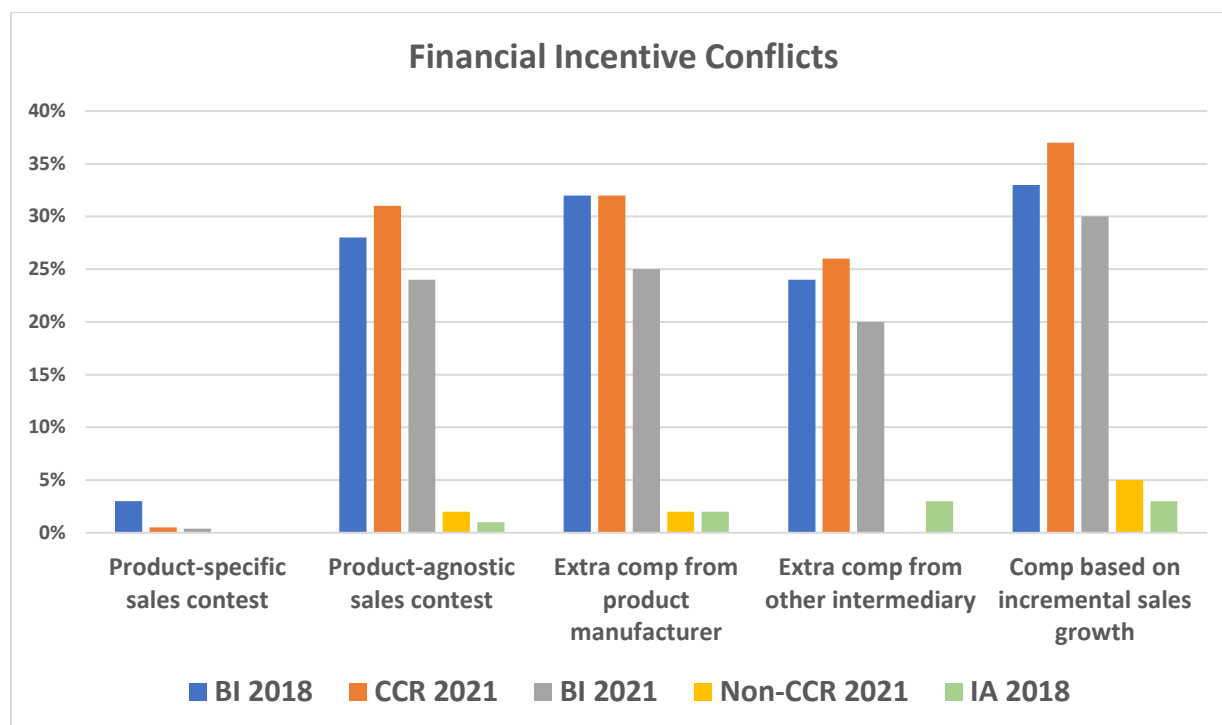
Firms recommending...	Private Securities	Variable Annuities	Non-traded REITs	Leveraged or Inverse ETFs
Participate in product-agnostic sales contests	36%	34%	40%	25%
Receive extra compensation beyond commission from product manufacturer	34%	36%	44%	25%
Receive extra compensation beyond commission from another intermediary	30%	30%	40%	30%
Receive conference or training reimbursement from product manufacturer or trade association	64%	74%	83%	80%

Financial incentive conflicts like these were rare in non-CCR firms. On every count, Reg BI firms recommending CCR products had significantly higher concentrations of financial incentive conflicts than (a) Reg BI firms not recommending them and (b) IA firms. The Committee also found these financial incentive conflicts more concentrated in firms dually registered with a federal adviser (49%) than with standalone broker-dealers (38%) or firms dually registered with a state adviser (13%).

Financial incentive Conflicts	CCR (2021)	Non-CCR (2021)	IA (2018)
Participation in product-specific sales contest	0.5%	0%	0%
Participation in product-agnostic sales contest	31%	2%	1%
Receipt of extra compensation beyond commission from product manufacturer	32%	2%	2%
Receipt of extra compensation beyond commission from another financial intermediary	26%	0%	3%

Receipt of conference or training reimbursement from product manufacturer or trade association	67%	11%	--
Compensation based on incremental sales growth	37%	5%	3%
Differential compensation	37%	3.5%	0.5%

The chart below illustrates the wide gulf between Reg BI and fiduciary firms when it comes to the use of financial incentive conflicts and how non-CCR firms within the Reg BI group (regardless of registration type) align very closely with and, in one metric, fared even better than IAs in avoiding conflicts. CCR firms in the Reg BI group (regardless of registration type), on the other hand, consistently fared much worse, suggesting product-centric reform may be the most efficient and effective way to promote compliance with Reg BI’s care and conflict of interest obligations.



CONFLICT MITIGATION

As an alternative to conflict avoidance, firms have the option under Reg BI to disclose and mitigate financial incentive conflicts. In Reg BI’s adopting release, the SEC emphasized that mitigation strategies would need to be heightened with unsophisticated customers and with less-transparent incentives as in the case of bonus and third-party compensation. Because these incentives were concentrated in the CCR firms in the sample, the Committee examined the mitigation strategies used by these firms.

In Reg BI's adopting release, the SEC suggested mitigation strategies that firms could use to prevent harm to retail customers, which strategies the Committee has categorized into three groups: (1) product-centric strategies that restrict product sales based on customer specifications; (2) reward-centric strategies that restrict the financial reward or incentive itself; and (3) broker-centric strategies that restrict the broker. While the first strategy is one that broker-dealers have long used to limit their own liability risk in selling CCR products under the suitability standard, very few of the CCR firms changed those policies or procedures to allow more careful matching for due diligence purposes or to mitigate incentive conflicts under Reg BI. For example, only 7% of the firms reported revising policies or procedures to restrict the sale of variable annuities based on customer specifications; only 4% for non-traded REITs; 3% for leveraged or inverse ETFs, and 3% for private securities.

The second set of mitigation strategies suggested by the SEC target the financial reward itself in order to reduce the incentive. Examples include avoiding agent compensation based on incremental sales growth; eliminating incentives within comparable product lines (i.e., differential compensation); and minimizing incentives to favor account type or product. About half the firms utilized these mitigation strategies impacting compensation model (e.g., avoided incremental sales and differential compensation models) but the other half resisted those strategies. The data shows that the resistant half also balked at other reforms that would have at least minimized the incentive or resulting customer harm inherent in the compensation model (e.g., capping sales credit or neutralizing customer cost).

Firms recommending...	Private Securities	Non-traded REITs	Variable Annuities	Leveraged or Inverse ETFs
used exception reports as supervisory tool to monitor compliance	39%	41%	46%	85%
do not compensate agent based on incremental sales growth	55%	52%	59%	55%
do not use differential compensation within comparable product line	55%	41%	58%	50%
neutralize cost to customer when allowing differential compensation	12%	8%	12%	15%
cap compensation or sales credit that agent receives for sales within product family or comparable line	31%	30%	28%	35%

The third set of mitigation strategies suggested by the SEC (and, in the Committee's view, the weakest if used alone) are geared toward control of the broker – heightened supervision over brokers in high-risk areas and adjusting the compensation of brokers who fail to properly manage conflicts. The SEC specifically recommended these strategies for “higher compensating products” like the CCR products analyzed in this initiative. Heightened supervision procedures pertaining to a product type normally would be documented as a “product-specific” policy in a firm's policy and procedures manual and would typically be monitored with exception reports.

Most of the firms selling CCR products after Reg BI had “product-specific” policies and procedures, but it is not clear how those policies supervised sales in a more controlled or “heightened manner” where the firm was not restricting the product based on customer age, risk profile, or liquidity needs. Less than half of the firms used exception reports as a supervisory tool to monitor sales of CCR products. Exception reports were used by a strong majority (85%) of firms selling leveraged or inverse ETFs, however. States will be examining how effective all these mitigation practices have been to neutralize the cost, risk, and harm borne by retail customers in accepting conflicted recommendations reviewed during Phase II (B).

TITLES

One of the public policy concerns that Reg BI was adopted to address was investor confusion regarding the differences between broker-dealers and investment advisers. One of the ways that the SEC tackled this issue was to restrict broker-dealer use of the “advisor” or “adviser” title while acting in a broker-dealer capacity. Using the title in that manner blurs the lines between these two business models and gives investors a false impression regarding the capacity in which a firm or agent is operating. In 2018, many firms allowed their agents/ reps to use the “adviser” and “advisor” titles of trust while operating in a broker-dealer capacity: 29% of firms allowed agents/ reps to use “advisor” or “adviser” title while acting in broker-dealer capacity and 46% of those firms (13% of the total) had no prerequisites for using such title, such as requiring IAR registration. In 2021, the percentage of Reg BI firms using (or allowing their brokers to use) the title without dual licensure dropped to 7%.

INSURANCE

A collateral issue raised in the Reg BI releases with respect to differences in the standard of care and protections for retail investors is the extent to which registered firms carry E&O insurance for investor losses. In Phase I, the Committee found that over half of both the BD (62%) and IA (60%) firms surveyed carried E&O insurance, even where such insurance was not a regulatory requirement. In Phase II (A), the percentage for Reg BI firms in the control group rose to 71% after Reg BI. The percentage of firms excluding certain agents from coverage remained flat at 7%, which is higher than the percentage of IA firms that excluded representatives in Phase I (only 2%).

With respect to CCR products, where customer complaints and a firm’s potential liability exposure can be higher than with other traditional products, the Committee noted:

- 22% of the firms offering private securities did not carry E&O insurance and 6% of the firms who had insurance excluded the products from coverage. 7% of the firms

offering private securities also excluded at least some representatives from coverage.

- 10% of the firms offering non-traded REITs did not carry E&O insurance and 2% of the firms who had insurance excluded the products from coverage. 7% of the firms offering non-traded REITs excluded at least some representatives from coverage.
- 15% of the firms offering leveraged and inverse ETFs did not carry E&O insurance, 6% of the firms who had insurance excluded the products from coverage. 6% of the firms also excluded at least some representatives from coverage.
- 15% of the firms offering variable annuities did not carry E&O insurance, but all those with policies had coverage for sales of these products. 8% of the firms excluded at least some representatives from coverage.

PRESUMPTIVE BREACHES

Although Reg BI is a principles-based regulation, there are several straight-forward requirements laid out in the text of the rule and articulated in guidance. For example, in the rule, firms are specifically directed to implement policies and procedures to achieve compliance with the conflict of interest obligation and policies and procedures to achieve overall compliance with the rule as a whole. In guidance, the SEC warned non-dual registrants that continued use of the “advisor” or “adviser” title while operating in a broker-dealer capacity would constitute a presumptive breach of the disclosure obligation. The SEC also warned, in guidance, that time-sensitive, product-specific sales contests are banned under the rule because those financial incentive conflicts are not capable of reasonable mitigation. Yet, in Phase II (A), the Committee found at least a few presumptive breaches of each of these requirements. There were firms servicing retail accounts without any policies or procedures to govern the firm’s conflicts of interest (and a few firms bold enough to claim they have no conflicts to manage). There were a few non-dual registrants still calling themselves advisors and a few product-specific sales contests. Fortunately, firms with these particular issues represented the exception rather than the rule. The Committee encourages states to contact these firms in Phase II (B) to help them come into compliance.

CONCLUSION

As Reg BI seeks to move broker-dealers to more “principles-based” regulation no less stringent than the fiduciary framework applicable to investment advisers, NASAA’s Phase II exam initiative indicates that the industry is taking steps in the right direction, just very small ones at this early juncture. The tentative behavior is not wholly unexpected given the regulatory shift away from “bright-line tests” toward “facts and circumstances” inquiries. To clarify regulatory expectations, NASAA and the states look forward to

collaborating with the SEC and FINRA to provide more proactive and clearer guidance to these firms. For Reg BI to be successful and live up to its “best interest” label, securities regulators will need to see to it that firms do a much better job of providing fair and balanced point-of-sale disclosure regarding fees, costs, and risks, particularly where a firm is recommending the most expensive and riskiest products in the retail market. Securities regulators cannot allow firms to continue to hide the ball when it comes to lower-cost and lower-risk options. Complex, costly, and risky products must be more carefully managed. Securities regulators will also need to see to it that firms do more to eliminate and mitigate harmful financial incentive conflicts. Otherwise, these conflicts will continue to morph into mis-matched recommendations that result in investor loss, complaint, and regulatory enforcement. With clearer guidance and dedicated oversight, Reg BI can get broker-dealers on the right track so that the interests of retail investors come first and are truly “best” served.

APPENDICES

Appendix A: Control Subgroup - Differences Between Reg BI Firms Pre- & Post-BI

I. BASIC FIRM STATS

		Pre-BI (2018)	Post-BI (2021)
Total Firms		225	225
Breakdown based on firm's registration type			
	BD only	39%	39.5%
	Dual with SEC adviser	43%	43.5%
	Dual with state adviser	18%	17%
Provided the following services to retail customers through a brokerage account...			
	Client-directed brokerage	79%	78%
	Recommended brokerage	85%	86%
	Managed brokerage	36%	30%
	Financial planning	31%	26%
	Account monitoring	24%	19%
	Other service	9%	8%
Number of retail customers serviced		50 million	77.6 million
Number of registered persons employed		275,000	316,000

II. PRODUCT OFFERINGS

	Pre-BI (2018)	Post-BI (2021)	
Equities	194	193	
Debt/fixed income	186	184	
Options	149	144	
Mutual funds	209	211	
Variable annuities	176	172	
Indexed annuities	138	132	
Municipal funds and 529 plans	176	178	
Unlisted direct participation programs (e.g., limited partnership, TIC, non-traded REITs)	89	78	
Listed REITs	155	149	
Hedge funds	30	34	Increase >10%
Standard ETFs/ETNs	173	172	
Leveraged or inverse ETFs/ETNs	91	76	
Penny stocks or other thinly-traded securities	118	115	
Derivatives	32	28	
Highly-leveraged products	20	16	
Private securities	69	78	Increase >10%
Cryptocurrency or other digital assets	2	7	Increase >10%
Proprietary products	53	45	
No-load products	137	121	
Unit investment trusts	143	135	
Structured products (e.g., market-linked notes, reverse convertibles)	82	89	Increase >10%
Special-purpose Acquisition Companies (SPACs)	--	39	

III. USE OF "ADVISER/OR" TITLE

	Pre-BI (2018)	Post-BI (2021)
Ban (or require dual licensure as a condition to) use of the title of "advisor" or "adviser" while operating in the capacity of a broker-dealer	83%	93%

IV. DUE DILIGENCE

	Pre-BI (2018)	Post-BI (2021)
Use an investor profile form	94%	99%
Use investor profile forms that capture customer education	22%	21%
Use investor profile forms that capture customer debt	28%	30%
Use Suitability/Best Interest/Fiduciary policies, procedures, or forms	84%	96%
Have policies and procedures regarding IRA rollovers	75%	84%
Have share class policies and procedures	80%	83%
Use cost/product comparison forms or other tools utilized for this purpose	54%	68%

V. DISCLOSURE

	Pre-BI (2018)	Post-BI (2021)
Have a policy to affirmatively discuss fee differences at time of recommendation	32%	50%
Have a policy to affirmatively discuss lower-cost options <i>inside the firm</i> with customers	21%	31%
Have a policy to affirmatively discuss lower-cost options <i>outside the firm</i> with customers	11%	19%
Have a policy to disclose outside the Form CRS the average fees charged for account type	26%	45%
Have at least one policy or procedure related to the disclosure of some fee	81%	92%
Educate customers on the general pros and cons of selecting competing account types	28%	45%
Educate customers on the pros and cons of IRA rollovers	47%	68%

VI. FINANCIAL INCENTIVES CONFLICTS - COMPENSATION PRACTICES

	Pre-BI (2018)	Post-BI (2021)
Utilize product-specific sales contests, quotas, or bonuses to compensate representatives	3%	0.4%
Utilize sales contests, quotas, or bonuses for proprietary product	2%	1%
Utilize sales contests, quotas, or bonuses that are not tied to a specific product	28%	24%
Tie agent/rep compensation to sales of a proprietary product	8%	9%
Accept third-party compensation beyond up-front commission <i>from a product manufacturer or sponsor</i> on account of sale/advice to retail customers	32%	25%
Accept third-party compensation beyond up-front commission <i>from another broker-dealer, investment adviser, or other financial institution</i> on account of sale/advice	24%	20%
Accept third-party compensation beyond commission <i>from an insurance marketing organization</i> on account of sale/advice to retail customers	27%	19%
Permit conference or training reimbursement by product manufacturer, trade association, or insurance marketing organization.	--	54%
Advertise "zero commission" trades	5%	4%
Tie compensation to asset accumulation	22%	21%
Tie compensation to incremental sales growth	33%	30%
Tie incentive/bonus/compensation to launch of closed-end fund or time-limited product	1%	1%
Allow differential compensation within product family or comparable product lines	30%	29%

VII. GENERAL CONFLICT / RISK MANAGEMENT

	Pre-BI (2018)	Post-BI (2021)
Carry E&O insurance	68%	71%
Have a conflict of interest register or catalog identifying known firm conflicts of interest	36%	62%
Have conflicts of interest policies and procedures	68%	86%
Have product-specific policies and procedures	87%	92%
Cap the compensation or sales credit that agent receives for sales within product family or comparable line	16%	20%
Neutralize cost to customer where differential compensation is used ((%) out of # firms using differential compensation)	21%	32%
Removed of at least one product from their platform on account of Reg BI	--	7%
Adopted at least one new policy or procedure to restrict sales for a product on account of Reg BI	--	24%
Ceased at least one of the compensation practices (financial incentive conflicts) on account of Reg BI	--	64%
Ceased utilization of the following financial incentive as the result of Regulation Best Interest...		
...Accepting third-party compensation beyond commission from a product manufacturer or sponsor on account of sale/advice	--	6%
...Accepting third-party compensation beyond commission from another broker-dealer, investment adviser, or other financial institution on account of sale/advice	--	4%
...Accepting third-party compensation beyond commission from an insurance marketing organization	--	4%
...Agent compensation tied to asset accumulation	--	4%
...Agent compensation tied to incremental sales growth	--	5%
...Incentive/bonus/compensation tied to launch of closed-end fund or other time-limited product	--	5%
...Allowing differential compensation tied to sales of proprietary product	--	5%
...Accepting reimbursement for conference or training program expense from product manufacturer, trade association, or insurance marketing organization	--	1%
...Utilizing product-specific sales contests, quotas, or bonuses	--	6%
...Utilizing sales contests, quotas, or bonuses that are not tied to a specific product	--	4%
...Agent compensation tied to sales of a proprietary product	--	5%
...Receiving administrative marketing or distribution fees (12b-1 fees) arising from mutual fund sales	--	2%

VIII. DUE DILIGENCE, DISCLOSURE, AND CONFLICT MANAGEMENT PERTAINING TO SALES OF COSTLY, COMPLEX, AND RISKY PRODUCTS (“CCR”)

		Pre-BI (2018)	Post-BI (2021)
<i>Offered to a retail customer</i>	At least one of the CCR listed	89%	100%
<i>Recommended to a retail customer...</i>	At least one of the CCR listed	89%	77%
	Private Securities	26%	28%
	Non-traded REITs	29%	26%
	Leveraged or inverse ETFs	23%	9%
	Variable annuities	68%	67%
	None during the review period	11%	23%
		(%) out of firms recommending CCR	
	Have no product-specific guidelines or product-specific training in place for recommended CCR	19%	5%
	Have no formal investment limitations tied to customer age and/or retirement status for recommended CCR	58%	47%
	Have no formal limitations tied to customer financial sophistication for recommended CCR	56%	44%
	Have no formal limitations tied to a customer's liquidity needs for recommended CCR	42%	32%
	Have no formal limitations tied to a customer's stated risk profile for recommended CCR	47%	38%
	Have no written policy to affirmatively disclose (outside of Form CRS and prospectus) amount of up-front commission	63%	36%
	Have no policy to affirmatively disclose (outside of Form CRS and prospectus) amount of deferred charges or fees	40%	14%
	Have no written policy to affirmatively disclose (outside of Form CRS and prospectus) amount of surrender, redemption, or exit fees	34%	6%
	Have no written policy to affirmatively offer and discuss <i>lower-cost</i> products when recommending CCR	45%	50%
	Have no written policy to affirmatively offer and discuss <i>lower-risk</i> products when recommending CCR	--	53%
	Have no written policy to affirmatively discuss (outside of Form CRS and prospectus) any material conflicts of interest associated with the CCR recommendations	56%	28%

Appendix B: Differences Between Reg BI and Fiduciary Firms

I. BASIC FIRM STATS

		BEST INTEREST (FINRA RETAIL) (2021)	FIDUCIARY (IA ONLY) (2018)
Total number		235	1,552
CCR	% recommending costly, complex, risky products	76%	14%
Non-CCR	% not recommending costly, complex risky products	24%	86%

II. PRODUCT OFFERINGS

	BEST INTEREST (2021)	FIDUCIARY (2018)	
Equities	86%	77%	
Debt/fixed income	81%	67%	
Options	64%	23%	41% difference
Mutual funds	94%	77%	
Variable annuities	76%	15%	61% difference
Indexed annuities	58%	14%	44% difference
Municipal funds and 529 plans	79%	33%	46% difference
Unlisted REITs and direct participation programs	35%	7%	28% difference
Listed REITs	66%	39%	
Hedge funds	15%	5%	
Standard ETFs/ETNs	77%	67%	
Leveraged or inverse ETFs/ETNs	32%	15%	
Penny stocks or other thinly-traded securities	50%	6%	44% difference
Derivatives	13%	3%	
Highly-leveraged products	7%	1%	
Private securities	34%	3%	31% difference
Cryptocurrency or other digital assets	3%	0%	
Proprietary products	20%	1%	
No-load products	53%	37%	
Unit investment trusts	59%	10%	49% difference
Structured products	39%	5%	34% difference
Special-purpose Acquisition Companies (SPACs)	17%	--	

III. SALES OF COSTLY, COMPLEX, AND RISKY PRODUCTS (“CCR”)

	BEST INTEREST (2021)	FIDUCIARY (2018)
<i>Offered</i> at least one of these products during review period	100%	27%
<i>Recommended</i> at least one of these products during review period...	76%	14%
... specifically recommended Private Securities	29%	3%
... specifically recommended Non-traded REITs	27%	2%
... specifically recommended Leveraged or inverse ETFs	9%	7%
... specifically recommended Variable annuities	66%	5%

IV. FINANCIAL INCENTIVES CONFLICTS – COMPENSATION PRACTICES

	BEST INTEREST			FIDUCIARY
	ALL BI (2021) out of 235	CCR (2021) out of 179	NON-CCR (2021) out of 56	IA (2018) out of 1,552
Utilized product-specific sales contests, quotas, or bonuses to compensate agents/representatives	0.4%	0.5%	0%	0%
Utilized sales contests, quotas, or bonuses for proprietary product	0.8%	1%	0%	0%
Utilized sales contests, quotas, or bonuses that are not tied to a specific product to compensate agents/representatives	24%	31%	2%	1%
Tied agent/rep compensation to sales of a proprietary product	9%	12%	2%	0.2%
Accepted third-party compensation beyond up-front commission <i>from a product manufacturer or sponsor</i>	25%	32%	2%	2%
Accepted third-party compensation <i>from another broker-dealer, investment adviser, or other financial institution</i>	20%	26%	0%	3%
Accepted third-party compensation <i>from an insurance marketing organization</i>	18%	25%	0%	3%
Permitted conference or training program reimbursement by a product manufacturer, related trade	53%	67%	9%	--

association, or insurance marketing organization				
Tied agent/representative compensation to asset accumulation	21%	27%	4%	16%
Tied agent/representative compensation to incremental sales growth	29%	37%	5%	3%
Allowed differential compensation within product family or comparable product lines	29%	37%	4%	0.5%

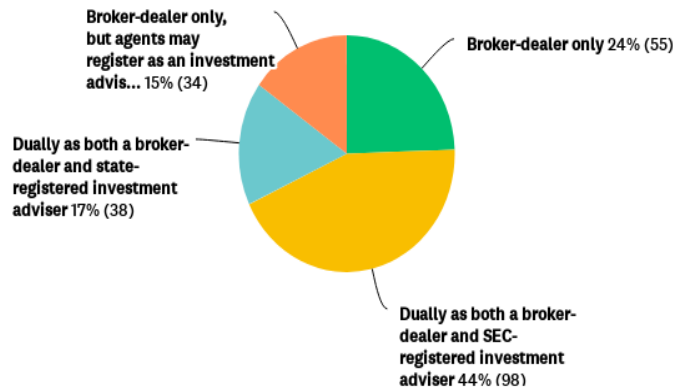
Appendix C: Post-BI Findings for CCR Firms By Product Type

	PRIVATE SECURITIES	NON-TRADED REITS	VARIABLE ANNUITIES	LEVERAGED OR INVERSE ETFs
sold by dual with federal adviser	43%	56%	55%	60%
sold by dual with state adviser	13%	11%	12%	20%
sold by standalone BD	43%	33%	33%	20%
did not carry E&O insurance	22%	10%	15%	15%
excluded product from E&O coverage	6%	2%	0%	6%
allowed advisor/er title without dual licensure	13%	16%	8%	15%
adopted no new P&P restrictions on product on account of Reg BI	69%	60%	70%	65%
had product-specific guidelines or training in place for product post-BI	93%	92%	91%	90%
had formal investment limitations tied to age or retirement status	39%	49%	49%	30%
had limitations tied to customer sophistication	66%	54%	36%	35%
had limitations tied to customer liquidity needs	69%	73%	60%	73%
had limitations tied to customer's state risk profile	64%	60%	50%	50%
used exception reports as supervisory tool to monitor compliance	39%	41%	46%	85%
received cash or non-cash compensation beyond commission on account of sales to retail customers	16%	11%	17%	5%
received third-party remuneration beyond commission on account of sales to retail customers	24%	30%	25%	5%
relied on prospectus and Form CRS as exclusive method of disclosure for this extra compensation	29%	23%	21%	20%
had a policy or practice of disclosing up-front sales commission to customer at time of recommendation	42%	59%	56%	25%
had a policy or practice of disclosing deferred compensation to customer at time of recommendation	33%	51%	81%	--

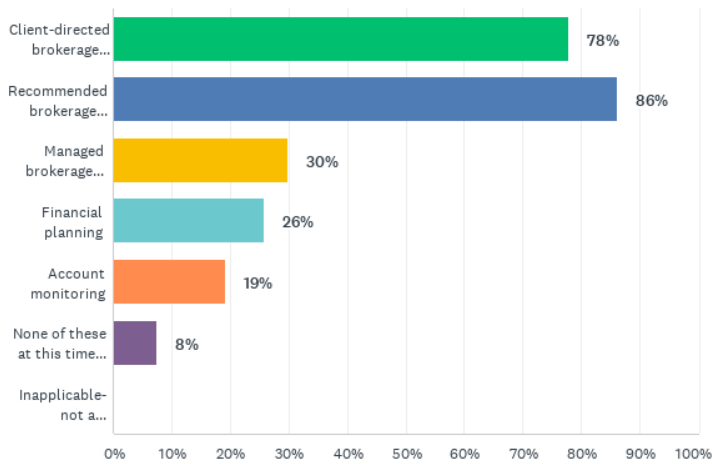
	PRIVATE SECURITIES	NON-TRADED REITs	VARIABLE ANNUITIES	LEVERAGED OR INVERSE ETFs
had formal P&P to affirmatively discuss lower cost option	24%	33%	33%	60%
had formal P&P to affirmatively offer and discuss lower-risk products when recommending product	24%	30%	46%	40%
had formal P&P to affirmatively discuss conflicts of interest when recommending product	63%	60%	66%	60%
asked about customer education level on investor profile form	19%	14%	14%	15%
asked about customer debt on investor profile form	24%	19%	31%	30%
used product-specific sales contests	1%	0%	1%	0%
used product-agnostic contests	36%	40%	34%	25%
accepted third-party compensation from product manufacturer/sponsor	34%	44%	36%	25%
accepted third-party compensation from another BD, IA, or other financial institution	30%	40%	30%	30%
accepted conference or training compensation from a product manufacturer or trade association comprised of product manufacturers	64%	83%	74%	80%
compensated reps based on incremental sales growth	45%	48%	41%	45%
allowed differential compensation	45%	59%	42%	50%
neutralize cost to customer when allowing differential compensation	12%	8%	12%	15%
lacked any policies and procedures pertaining to conflicts of interest	6%	6%	10%	15%
lacked a conflicts of interest register	19%	17%	17%	25%
lacked a conflicts committee/officer	34%	30%	32%	35%
stated firm has no conflicts	7%	5%	12%	10%
lacked cost/product comparison forms or other tools	30%	19%	19%	20%

Appendix D: Responses of Reg BI Firms in Control Subgroup (225 Firms)

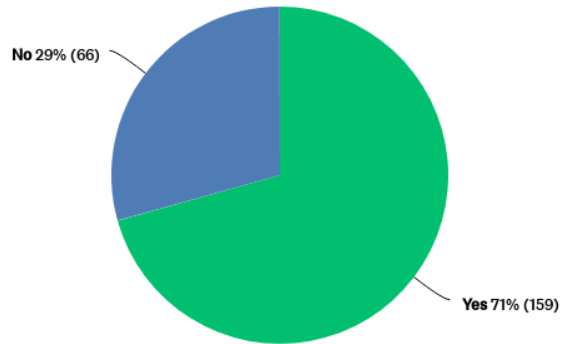
Q3 Please specify the firm's current registration(s).



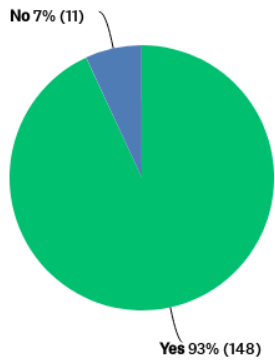
Q4 For broker-dealers (both dually registered and standalone), please indicate whether you currently provide the following services to retail customers through a brokerage account. Check all that apply.



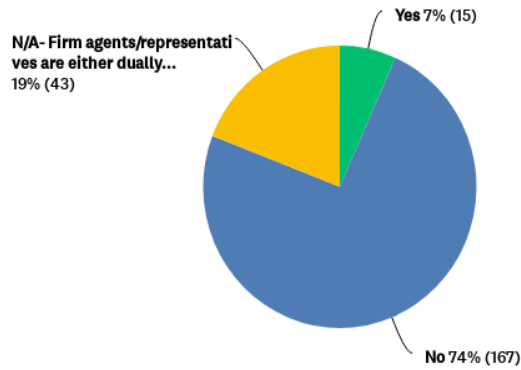
Q7 Does your firm currently carry E&O insurance?



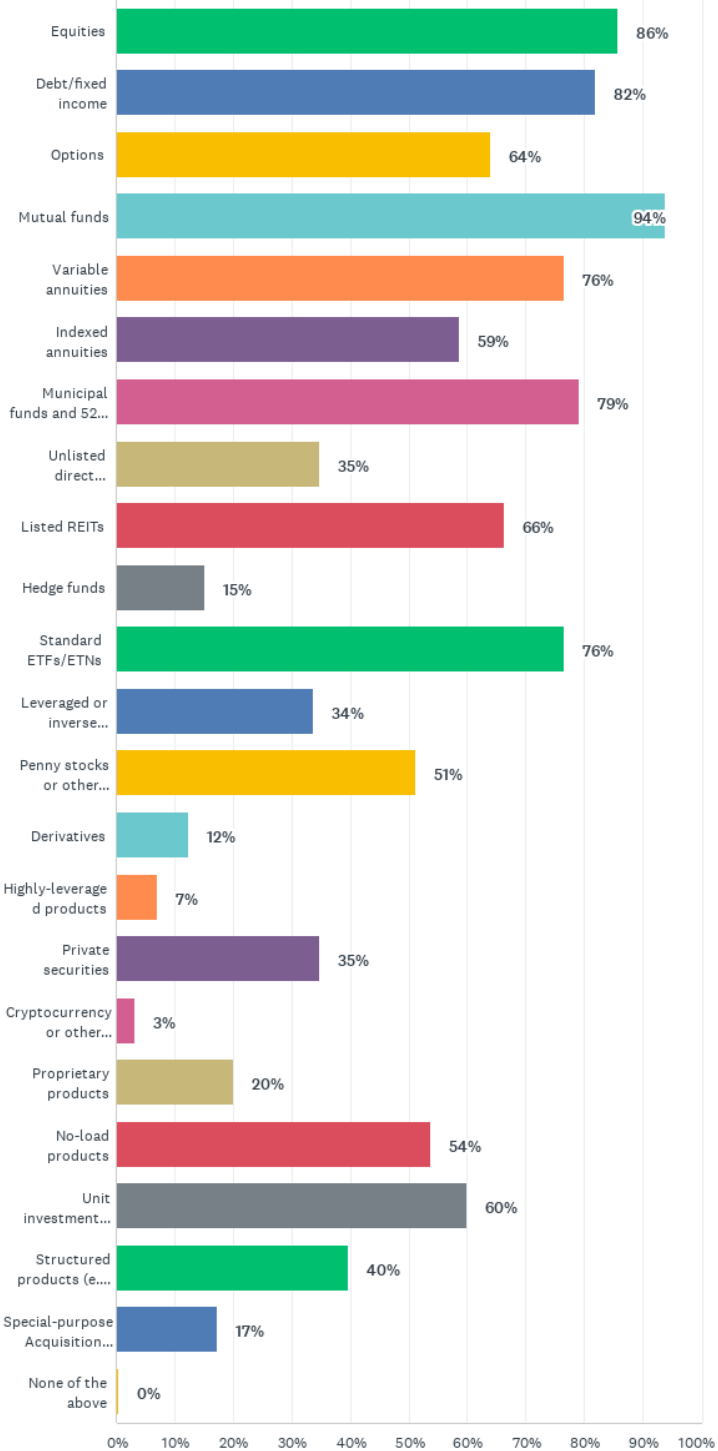
Q8 Does this policy cover all registered persons?



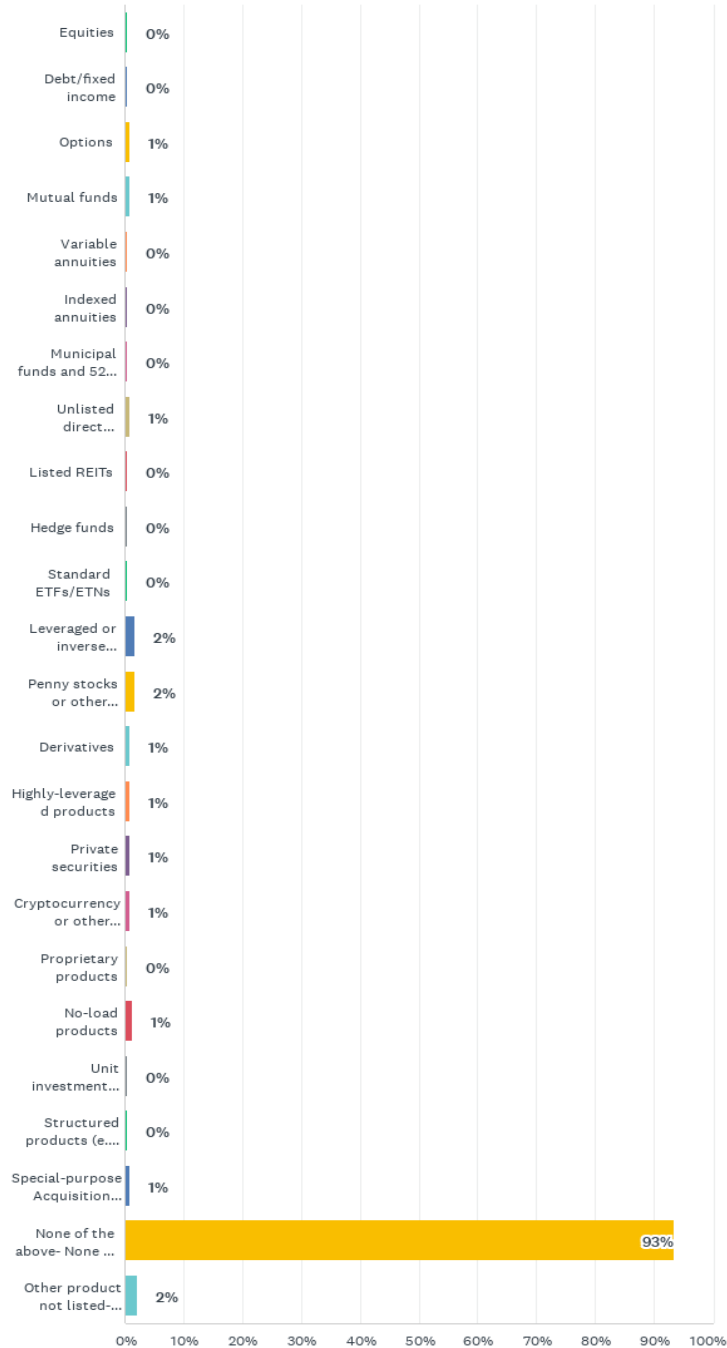
Q10 Please indicate if the firm or its registered agents/representatives currently use, or currently permit the use of, the title of "advisor" or "adviser" to describe itself or its registered agents/representatives while operating in the capacity of a broker-dealer without dual licensure/registration.



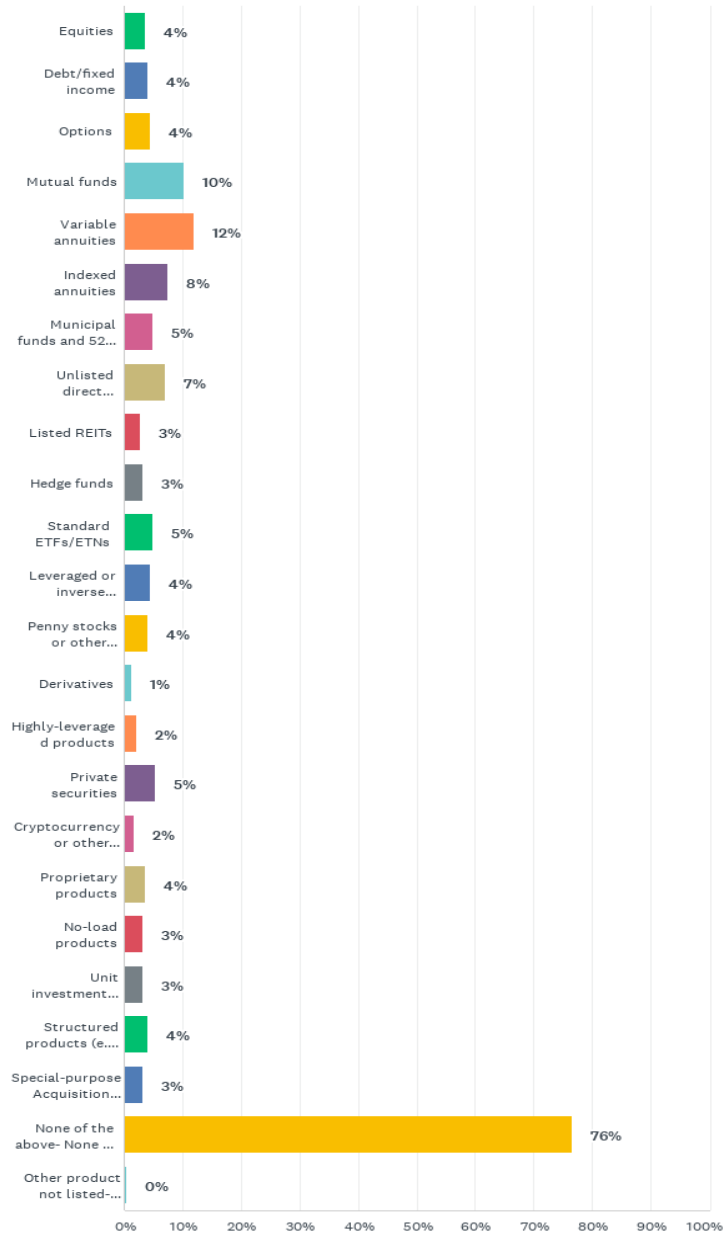
Q11 Please indicate whether you currently offer or make available to retail customers the following product types. Check all that apply.



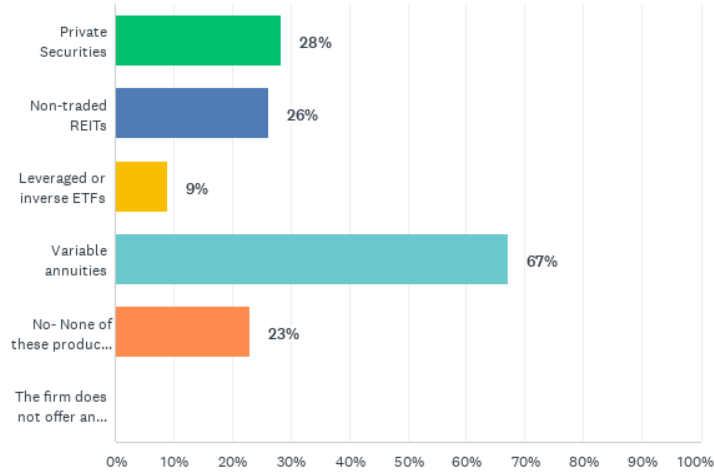
Q12 Please indicate whether you removed any of the following product types from your platform or ceased making any of the following product types available to retail customers as a result of Regulation Best Interest. Check all that apply.



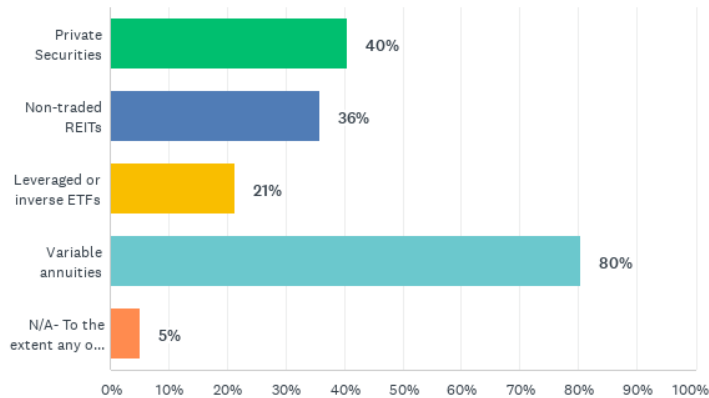
Q13 Please indicate whether you adopted any new policies or procedures to restrict sales (including, but not limited to, for example, by age, income/net worth, risk profile, special agent certification, compensation adjustment, elimination of financial incentive, etc.) of any of the following product types to retail customers as a result of Regulation Best Interest. Check all that apply.



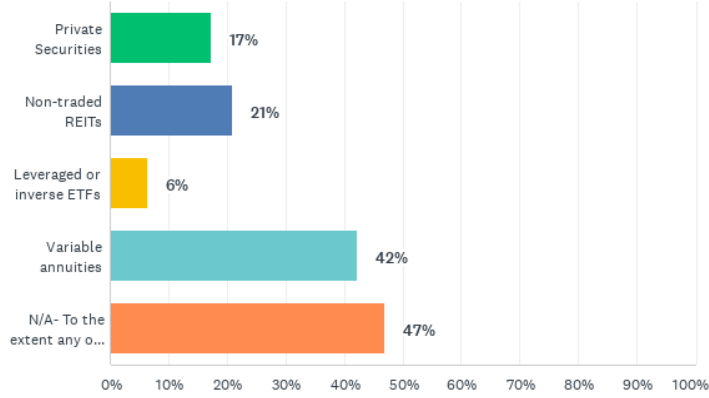
Q14 Did the firm or its agents/representatives recommend that a retail customer buy or sell any of the products listed below on or after July 1, 2020? Check all that apply.



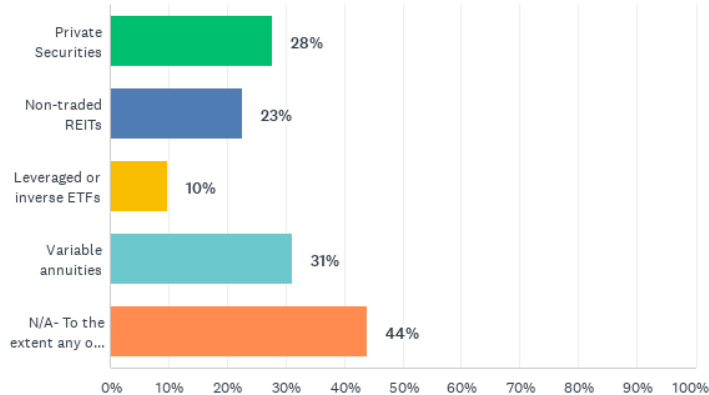
Q15 For which products did the firm have product-specific guidelines or product-specific training in place governing agent/representative recommendations to retail customers made on or after July 1, 2020? Check all that apply.



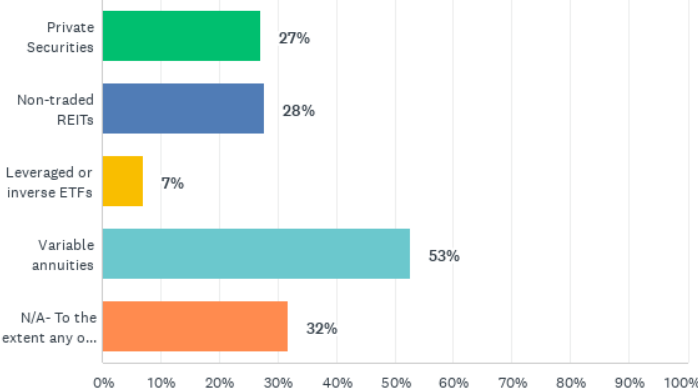
Q16 For which products were there formal investment limitations (written into the procedure manual) tied to customer age and/or retirement status applicable to retail customer recommendations on or after July 1, 2020?



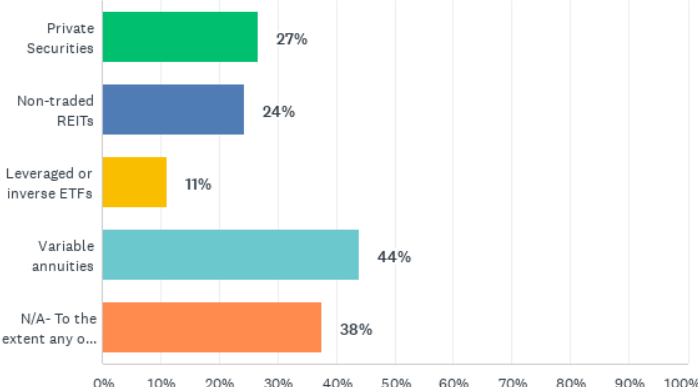
Q17 For which products were there formal limitations (written into the procedure manual) tied to customer financial sophistication applicable to retail customer recommendations on or after July 1, 2020? Check all that apply.



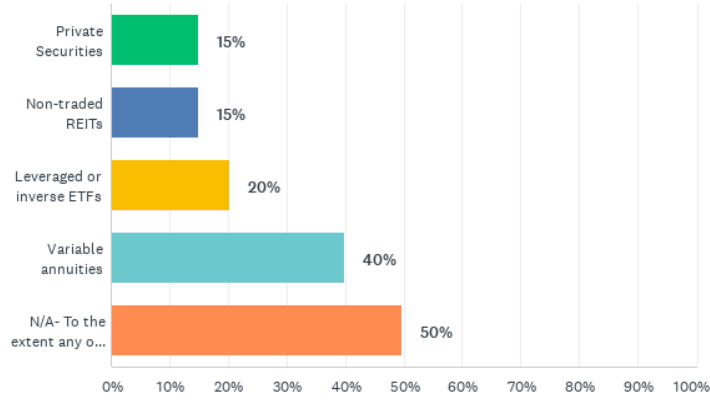
Q18 For which products were there formal limitations (written into the procedure manual) tied to a customer's liquidity needs (e.g., concentration limit) applicable to retail customer recommendations on or after July 1, 2020? Check all that apply.



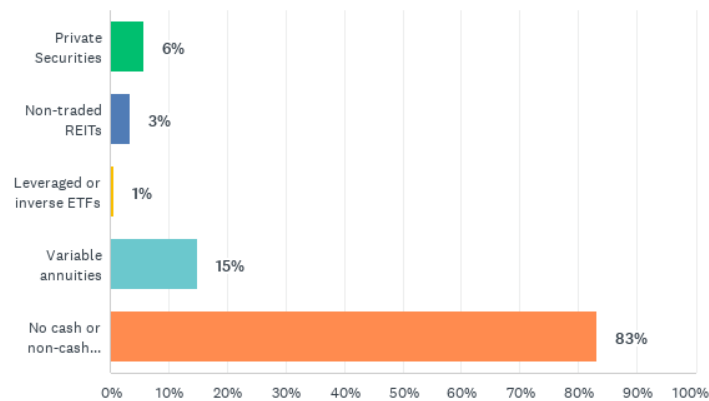
Q19 For which products were there formal limitations (written into the procedure manual) tied to a customer's stated risk profile applicable to retail customer recommendations on or after July 1, 2020? Check all that apply.



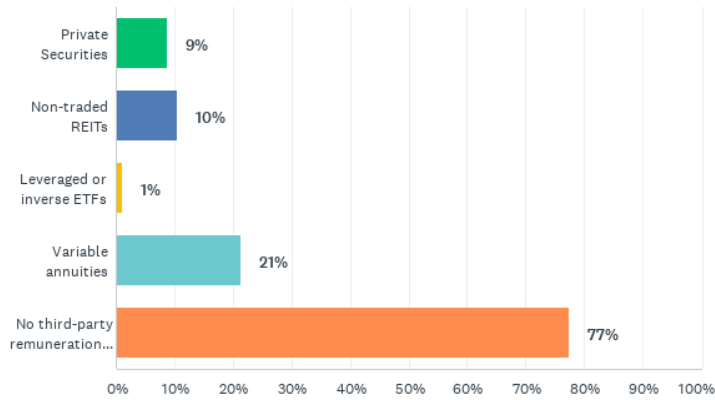
Q20 For which products did the firm use exception reports to monitor for compliance with limitations applicable to customer recommendations on or after July 1, 2020? Check all that apply.



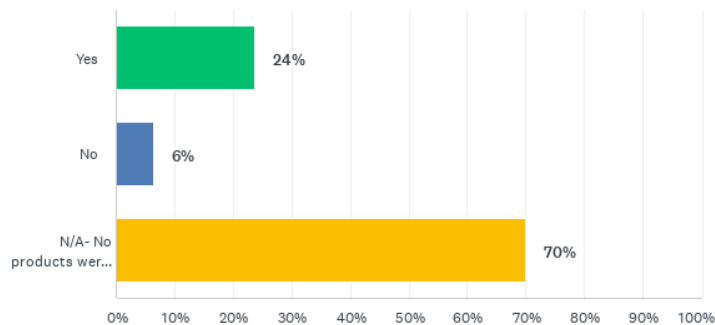
Q21 Beyond and excluding any applicable up-front sales commissions, did the firm or agents/representatives receive any cash or non-cash compensation (pursuant to a sales contest, quota, bonus, or otherwise) on account of retail sales involving any of the products listed below on or after July 1, 2020? Check all that apply.



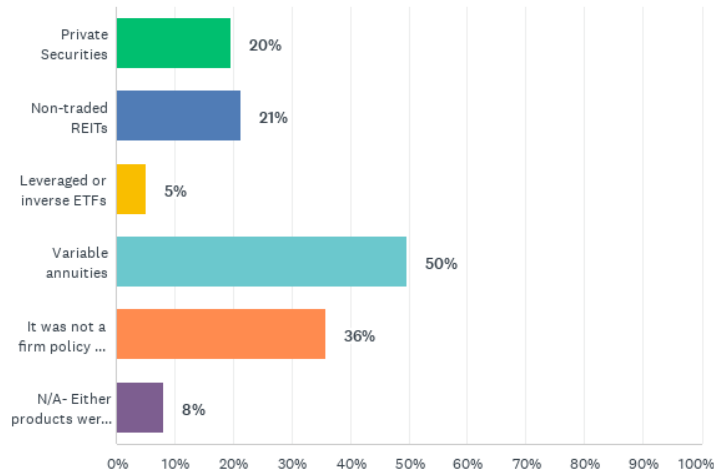
Q22 Beyond and excluding any applicable up-front sales commissions, for which products did the firm or agents/representatives receive any form of third-party remuneration (e.g., cash or non-cash, immediate, or deferred) on account of retail sales involving any of the products listed below on or after July 1, 2020? Check all that apply.



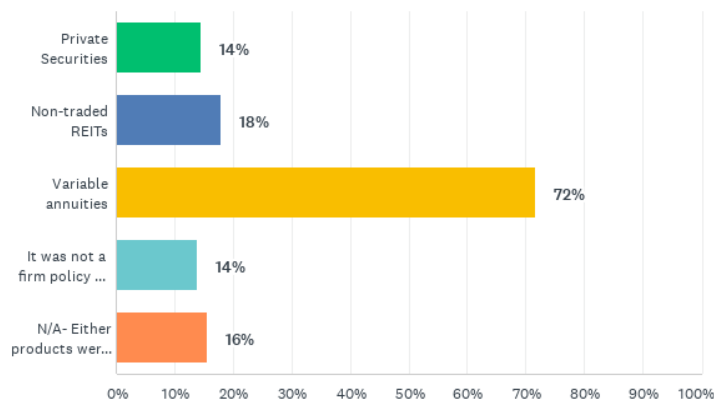
Q23 If any products in the previous two questions were checked (meaning firm or agent/representative received non-cash compensation or third-party remuneration on account of a retail sale outside of up-front sales commission), was the applicable incentive(s) disclosed to the customer at the time of the product recommendation, beyond and excluding disclosures found in the Form CRS and product prospectus?



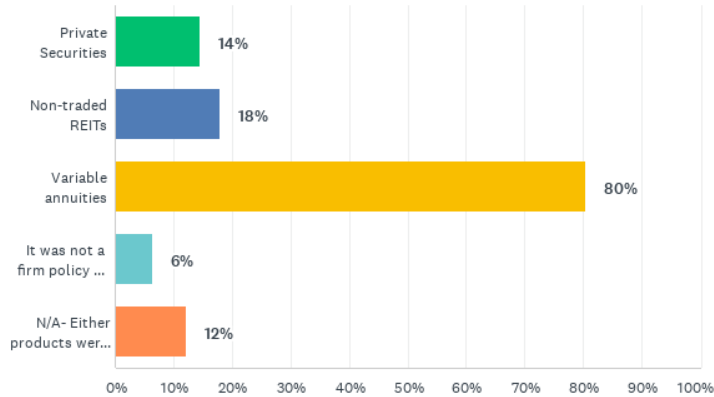
Q24 Check all products for which it was a formal written firm policy or expected practice (not formalized in a procedure manual) for agents/representatives to affirmatively disclose to retail customers the anticipated amount of the up-front sales commission at the time a recommendation was made concerning any of the products listed below on or after July 1, 2020, beyond and excluding disclosures found in the Form CRS and the product prospectus.



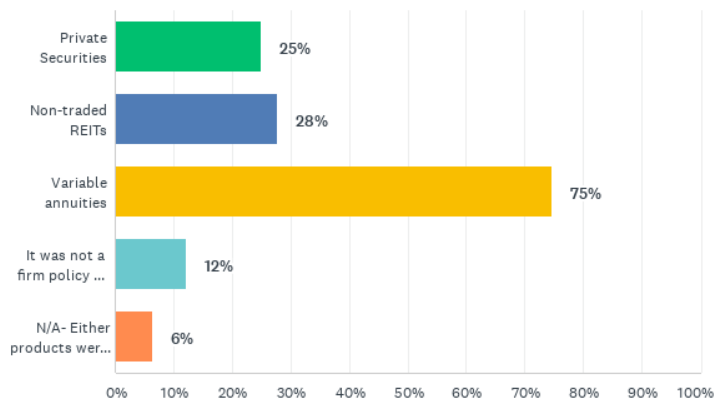
Q25 Check all products for which it was a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively disclose to retail customers the anticipated amount of any applicable deferred sales charges or other deferred management or service fees at the time a recommendation was made concerning any of the products listed below on or after July 1, 2020, beyond and excluding disclosures found in the Form CRS and the product prospectus.



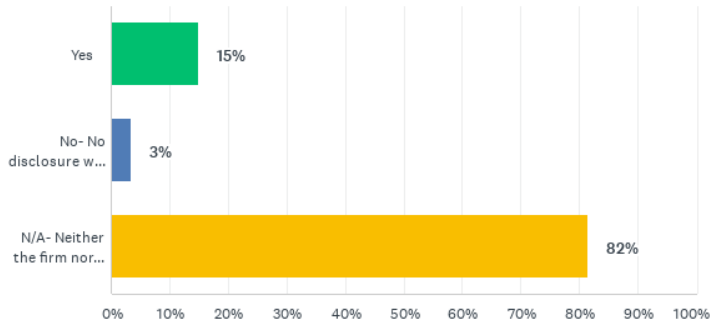
Q26 Check all products for which it was it a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively disclose to retail customers the anticipated amount of any applicable product surrender, redemption, or exit fees at the time a recommendation was made concerning any of the products listed below on or after July 1, 2020, beyond and excluding disclosures found in the Form CRS and the product prospectus.



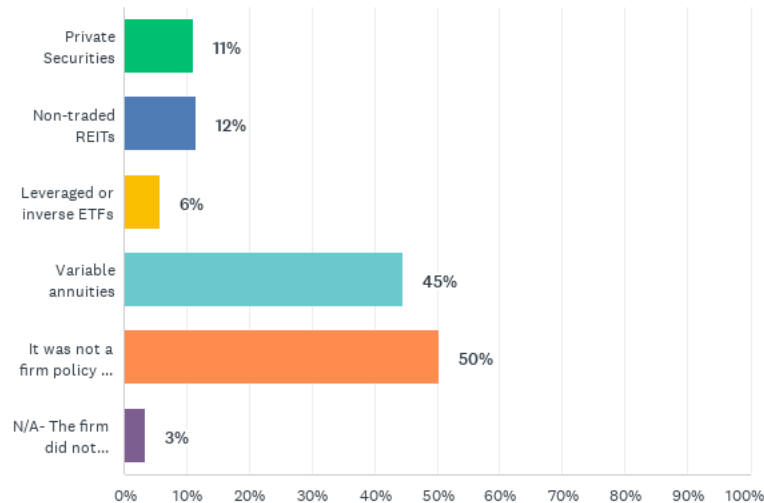
Q27 Check all products for which it was it a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively disclose to retail customers the withdrawal or redemption restrictions at the time a recommendation was made concerning any of the products listed below on or after July 1, 2020, beyond and excluding disclosures found in the product prospectus.



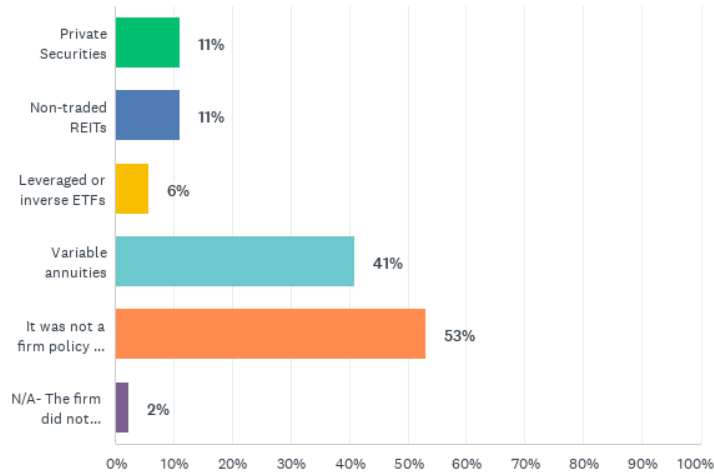
Q28 Did the firm or agent/representatives disclose, beyond and excluding disclosures found in the Form CRS and the product prospectus, the unique trading dynamics (e.g., daily resets) associated with leveraged or inverse ETFs at the time of recommendation when selling these products to retail customers on or after July 1, 2020?



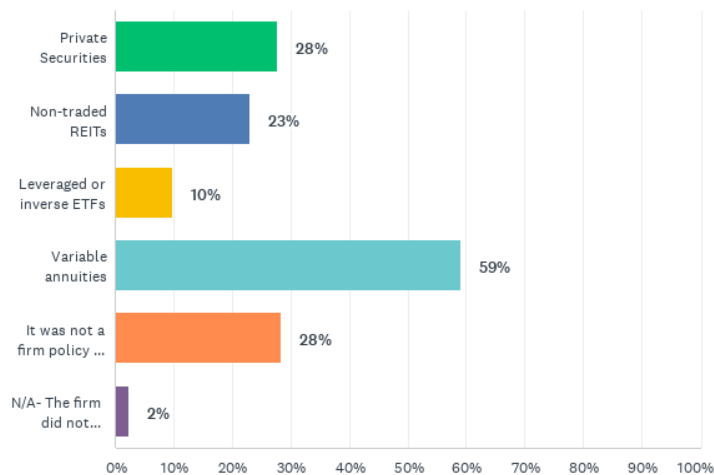
Q29 Check all products for which it was it a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively offer and discuss lower-cost products when recommending the products listed below to retail customers on or after July 1, 2020.



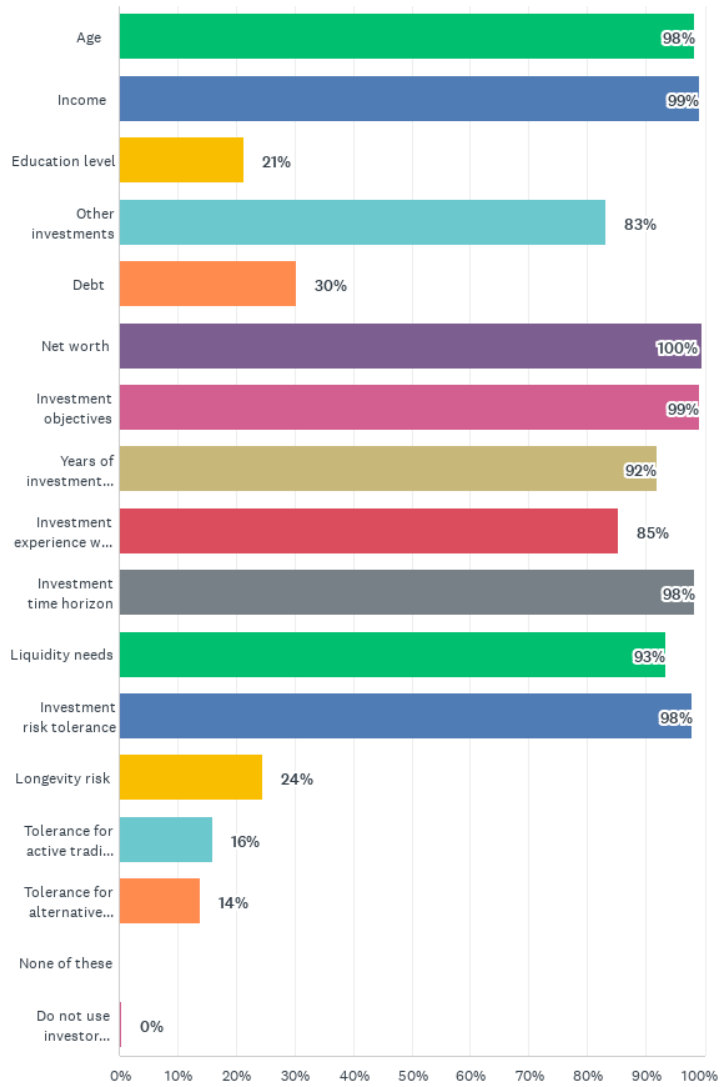
Q30 Check all products for which it was it a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively offer and discuss lower-risk products when recommending the products listed below to retail customers on or after July 1, 2020.



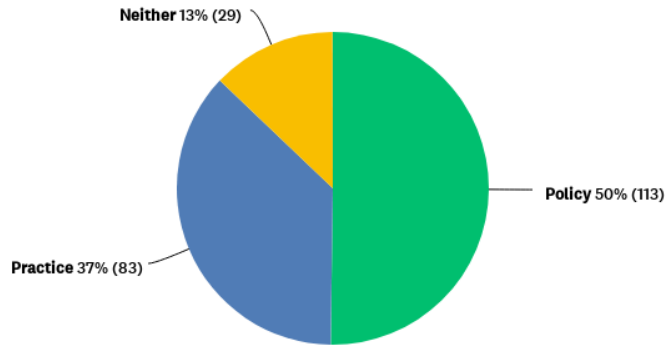
Q31 Beyond and excluding disclosures in Form CRS and the product prospectus, for which products was it a formal written firm policy or practice (not formalized in a procedure manual) for agents/representatives to affirmatively discuss any material conflicts of interest associated with recommendations to retail customers on or after July 1, 2020? Check all that apply.



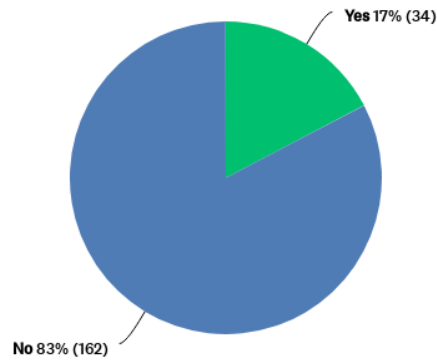
Q32 Please indicate whether the firm's investor profile form or questionnaire currently collects the following data points when working with retail customers:



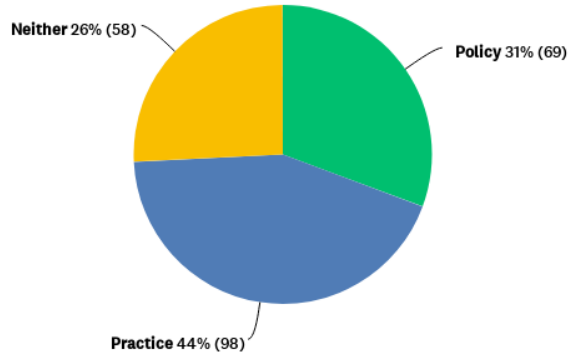
Q33 In relation to fees charged for various asset classes, is it policy or practice to affirmatively discuss fee differences with retail customers at the time of a recommendation to buy, hold, or sell a security.



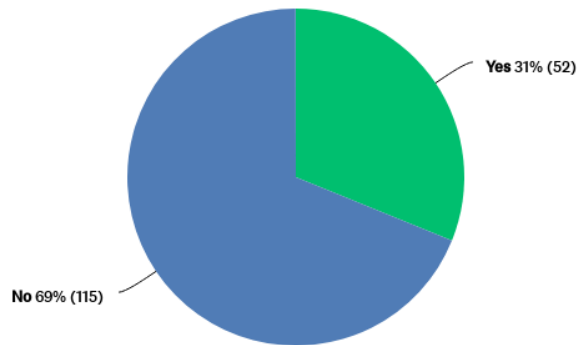
Q34 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



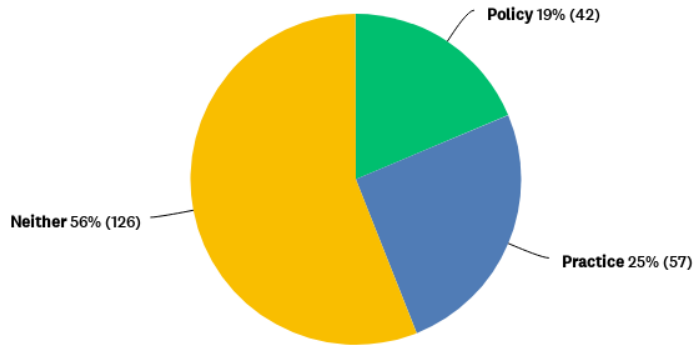
Q35 In relation to the availability of lower-cost, suitable options offered by the firm, please indicate whether it currently is a firm policy or practice to affirmatively discuss the lower-cost options with retail customers at the time of a recommendation to buy, hold, or sell a security.



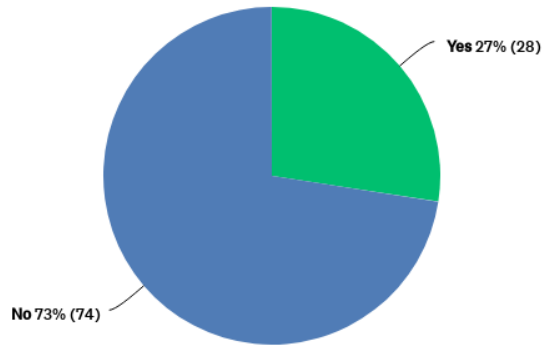
Q36 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



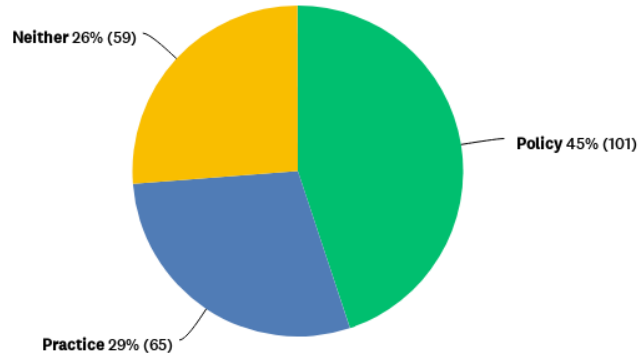
Q37 In relation to the availability of lower-cost, suitable options offered outside the firm, please indicate whether it currently is firm policy or practice to affirmatively discuss the lower-cost options with customers at the time of a recommendation to buy, hold, or sell a security.



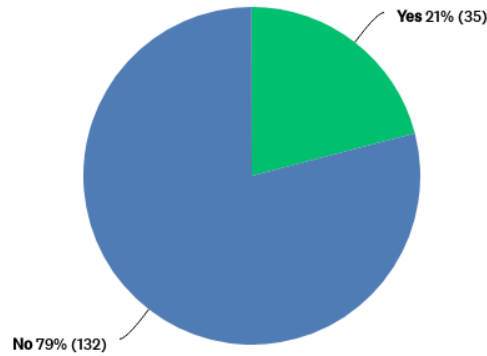
Q38 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



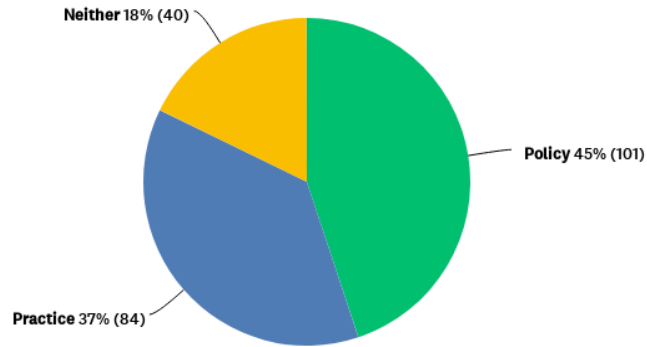
Q39 Please indicate whether it currently is a firm policy or practice to disclose or delineate outside the Form CRS, prior to or at account opening, the average fees in terms of fixed dollar charge, percentage of assets, or a percentage/dollar range that is typically charged for the recommended account type.



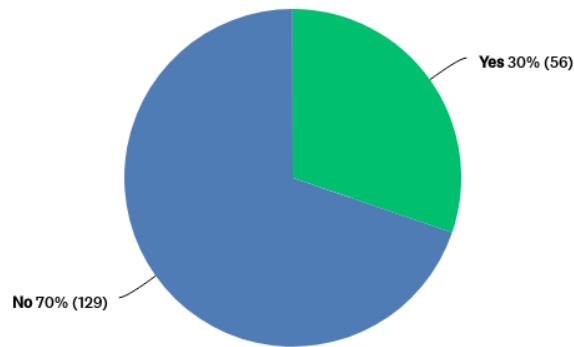
Q40 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



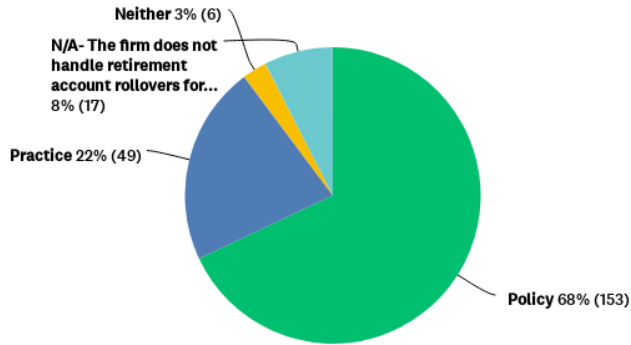
Q41 Educate customers on the general pros and cons of selecting competing account types (e.g., brokerage versus an advisory account).



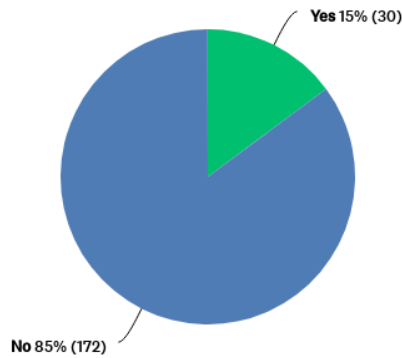
Q42 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



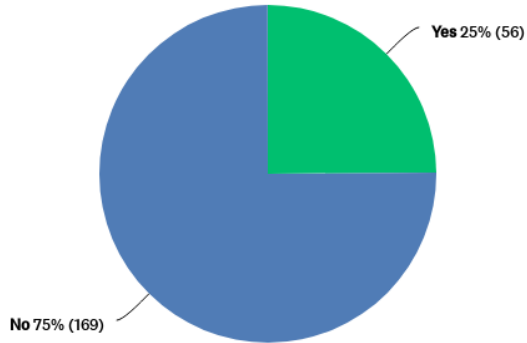
Q43 Educate customers on the pros and cons of rolling over assets from a workplace retirement account into an IRA or other firm account.



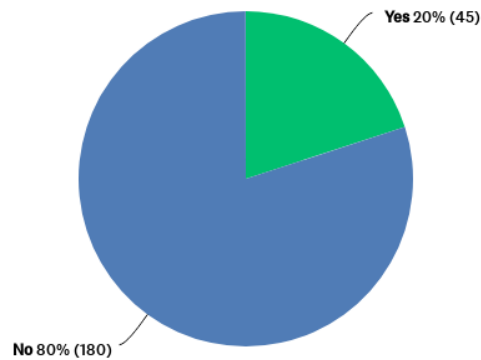
Q44 Please indicate whether the requirement was adopted as the result of Regulation Best Interest.



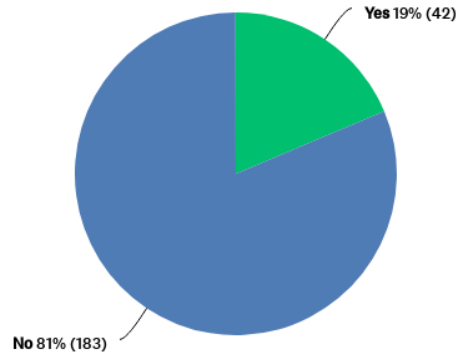
Q45 Excluding an up-front sales commission, accept third-party compensation (cash or non-cash, including gifts of travel or entertainment) from a product manufacturer or sponsor on account of sale/advice to retail customers



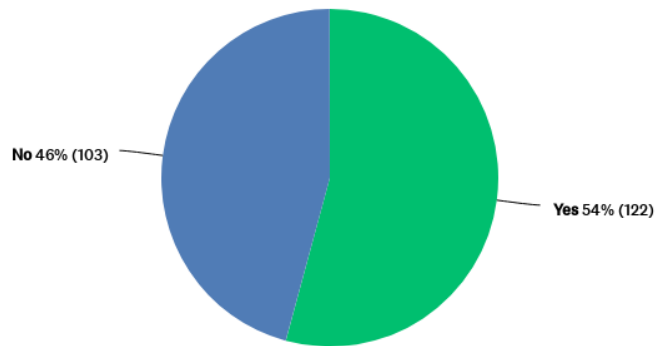
Q46 Accept third-party compensation (cash or non-cash, including gifts of travel or entertainment) from another broker-dealer, investment adviser, or other financial institution on account of sale/advice to retail customers



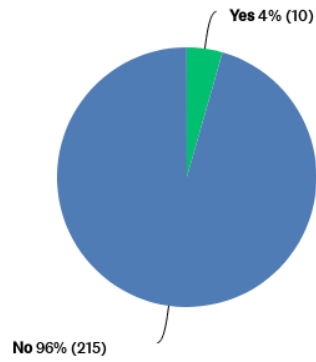
Q47 Accept third-party compensation (cash or non-cash, including gifts of travel or entertainment) from an insurance marketing organization on account of sale/advice to retail customers



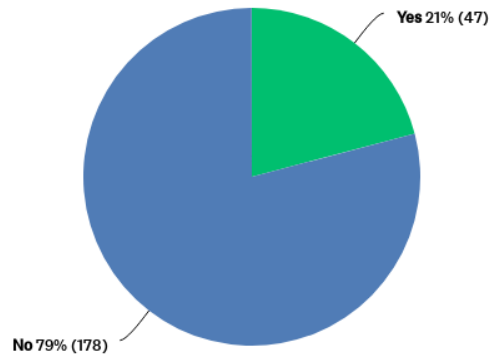
Q48 Permit conference or training program attendance where expenses are covered or reimbursed, in whole or in part, by a product manufacturer, a trade association comprised of product manufacturer members, or an insurance marketing organization.



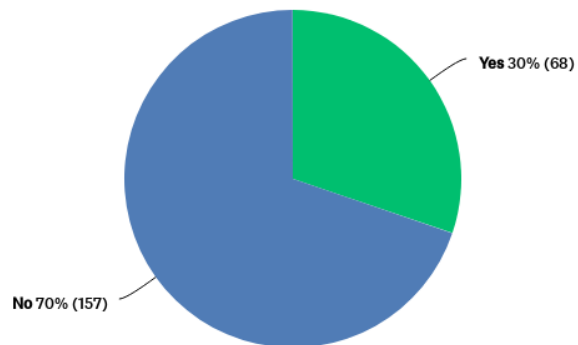
Q49 Advertise "zero commission" trades



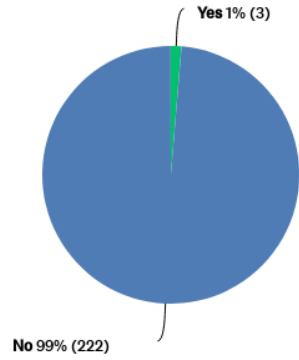
Q50 Agent/representative compensation tied to asset accumulation



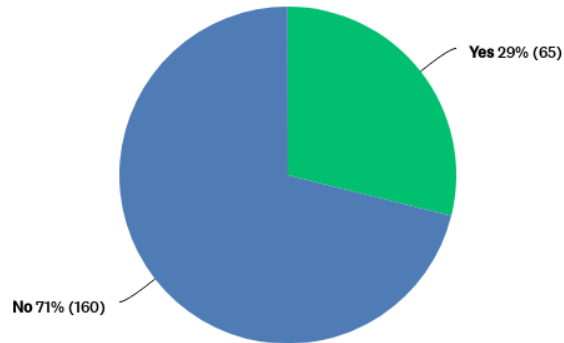
Q51 Agent/representative compensation tied to incremental sales growth



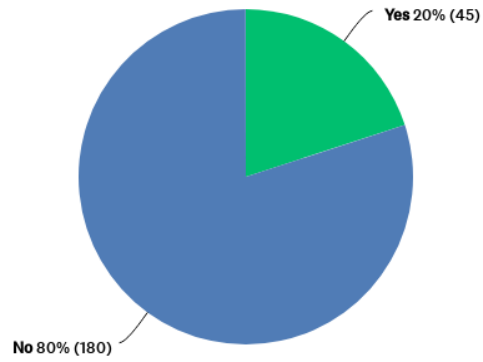
Q52 Incentive/bonus agent/representative compensation tied to launch of closed-end fund or other time-limited product



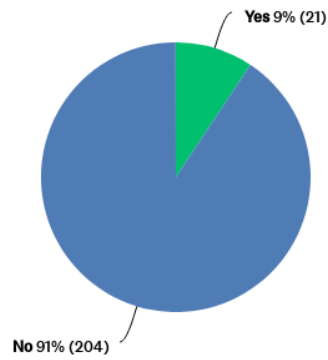
Q53 Allow differential compensation within product family or comparable product lines



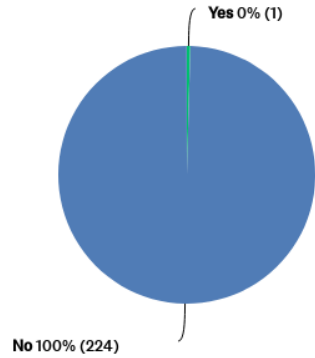
Q54 Cap the compensation or sales credit that an agent/representative receives for sales/advice within product family or comparable product lines



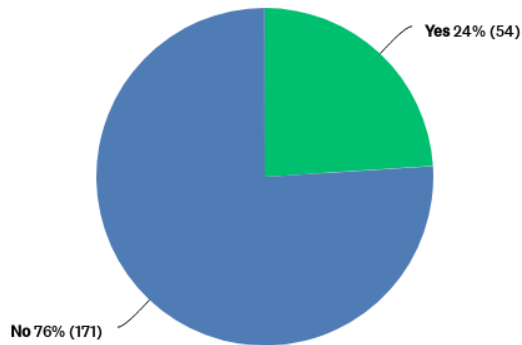
Q55 Neutralize cost to customer where differential compensation is utilized



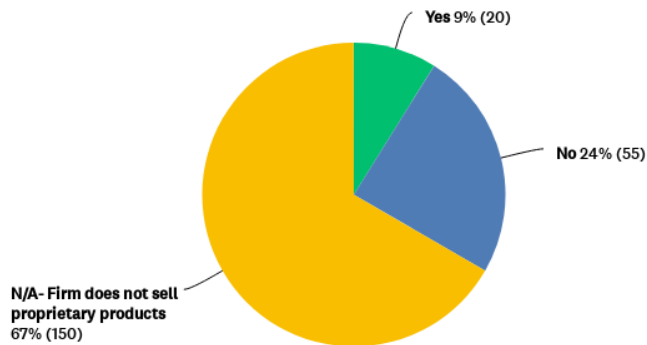
Q56 Utilize product-specific sales contests, quotas, or bonuses to compensate agents/representatives



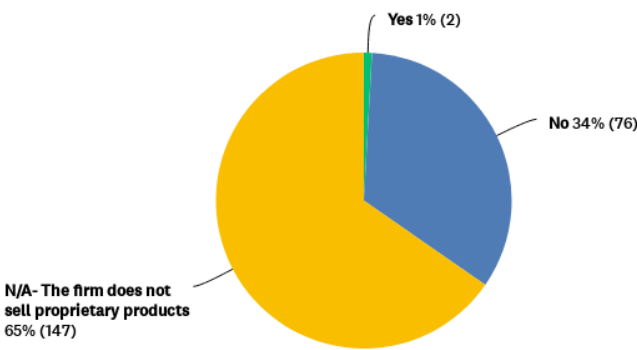
Q57 Utilize sales contests, quotas, or bonuses that are not tied to a specific product to compensate agents/representatives



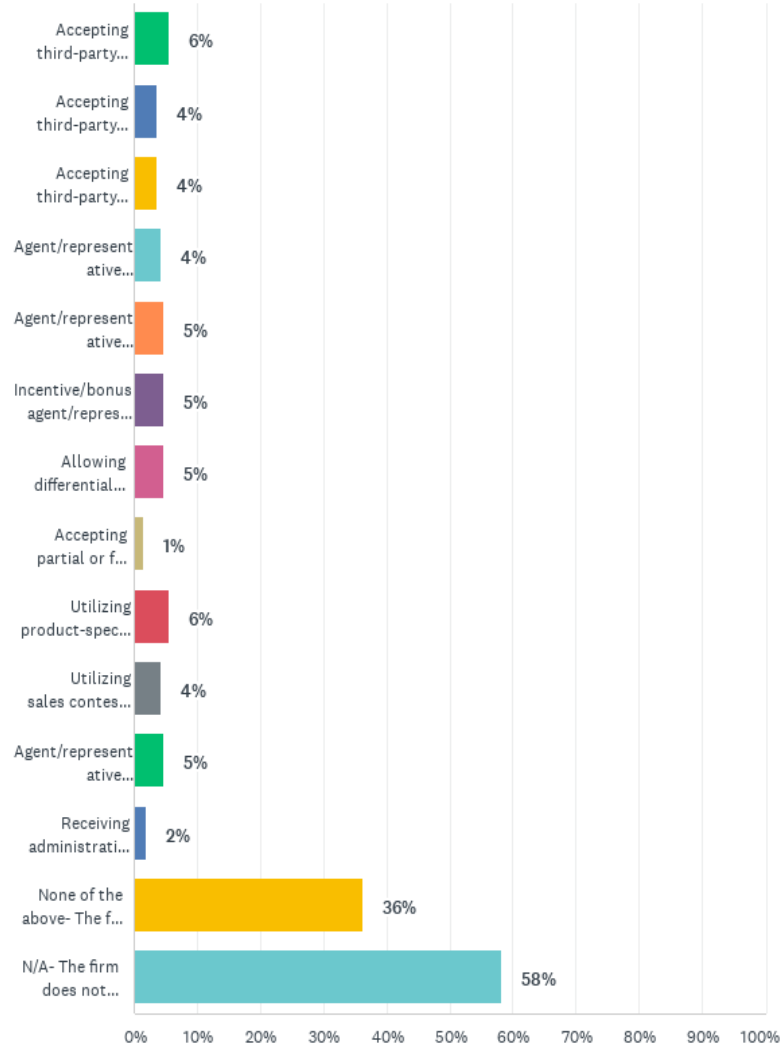
Q58 Agent/rep compensation tied to sales of a proprietary product



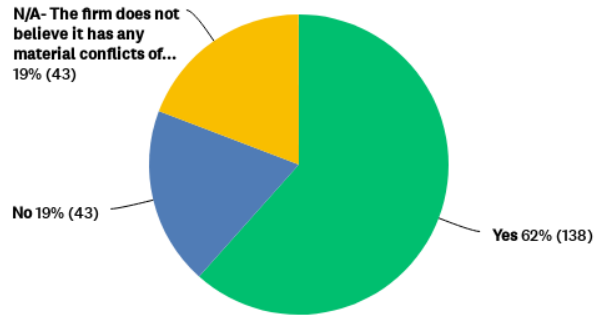
Q59 Utilize sales contests for a proprietary product



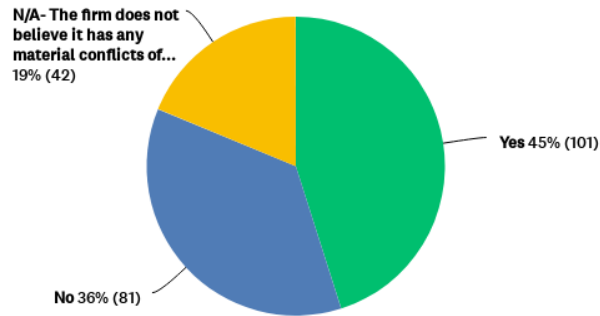
Q60 Please indicate whether the firm has ceased participation in any of the following compensation practices as the result of Regulation Best Interest. Check all that apply.



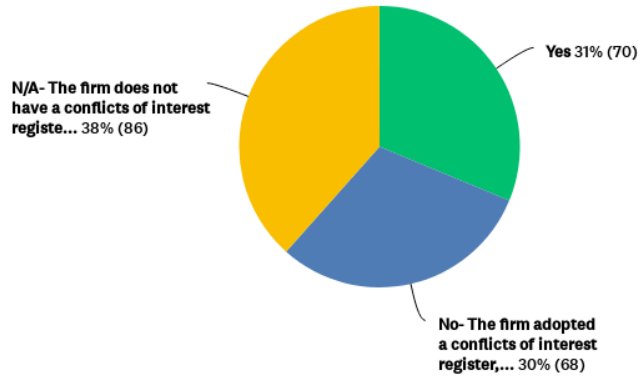
Q61 Please indicate whether the firm currently has a conflicts of interest register or catalog (i.e., a formal document identifying known firm conflicts of interest).



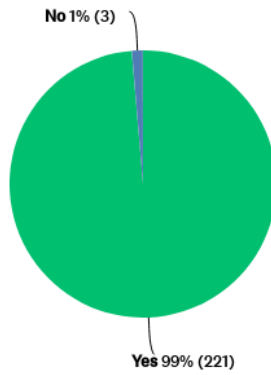
Q62 Please indicate whether the firm currently has a conflicts of interest committee or a designated conflicts officer.



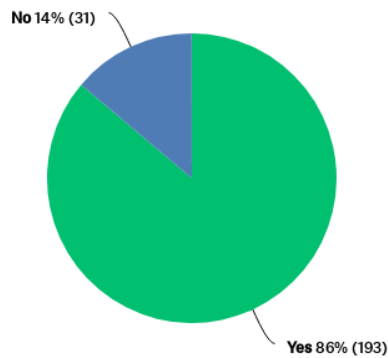
Q63 Please indicate whether the firm adopted a conflicts of interest register, committee, or officer as the result of Regulation Best Interest.



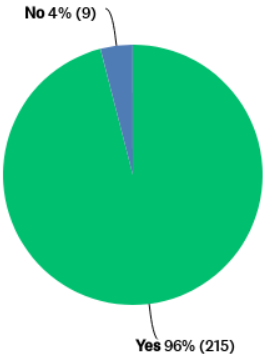
Q64 Investor profile questionnaire forms



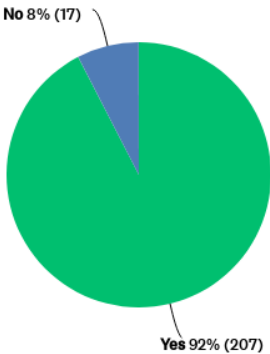
Q65 Conflict of interest policies and procedures



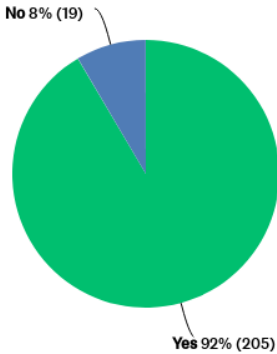
Q66 Suitability/Best Interest/Fiduciary Obligations policies and procedures and applicable questionnaires



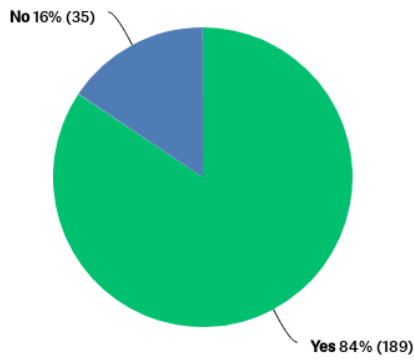
Q67 Policies and procedures related to the disclosure of any fees (e.g., commissions, account fees, etc.)



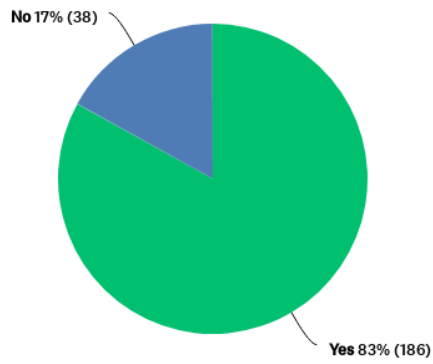
Q68 Product-specific policies and procedures



Q69 Policies and procedures regarding IRA/retirement account rollovers



Q70 Share class policies and procedures



Q71 Cost/product comparison forms or other tools utilized for this purpose

