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Submitted electronically via email to NASAAComments@nasaa.org

North American Securities Administrators Association, Inc.
750 First Street NE, Suite 990
Washington, DC 20002

Re: **Proposed Revisions to NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule**

Dear Sir or Madam:

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Broker-Dealer Market and Regulatory Policy and Review Project Group and the Broker-Dealer Section Committee of the North American Securities Administrators Association, Inc. ("NASAA") on its request for comment on proposed revisions to NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule ("NASAA Broker-Dealer Model Rule").[2] The proposed revisions to the rule are referred to throughout as the "Proposed Rule" and the Proposed Rule, together with the accompanying release, is referred to collectively as the "Proposal".

Fidelity has a longstanding and ongoing commitment to serving the diverse needs and interests of our customers by offering our customers a robust set of educational materials and tools and a choice of a broad range of financial products. Simply stated, our mission is to help strengthen and secure our customers' financial well-being. To advance that mission, Fidelity has long supported a requirement that broker-dealers and investment advisers act in the best interests of retail investors when providing investment advice. We have been actively engaged in the regulatory discussions on the standard of conduct for broker-dealers and investment advisers since 2013, which includes our support for the Securities and Exchange Commission's ("SEC")

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[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 40 million individuals and institutions, as well as through 13,500 financial intermediary firms. Fidelity submits this letter on behalf of Fidelity Brokerage Services LLC, an SEC-registered introducing broker-dealer and FINRA member and National Financial Services LLC, an SEC-registered clearing broker-dealer and FINRA member, and Fidelity companies otherwise impacted by the Proposal.

[2] *See* NASAA's Proposed Revisions to Dishonest or Unethical business Practices of Broker-Dealers Model Rule (September 5, 2023) ("Proposal"), available at https://www.nasaa.org/wp-content/uploads/2023/09/Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf.

adoption of Regulation Best Interest ("Reg BI").[3] Reg BI provides a strong, clear, practical and workable fiduciary standard for the provision of investment advice to retail customers and, together with other securities laws and rules, provides a robust set of regulations to protect customers.

Despite the robust standards of conduct applied to broker-dealers and the significant benefits investors receive from having access to different investment services, access to free guidance and education through online and in person interactions, NASAA has issued a Proposal which would impose an unworkable set of requirements on broker-dealers and the services they provide to investors. As discussed in more detail below, the Proposed Rule would, among other things:

- Abandon decades of securities industry practice and impose a broad and expansive new definition of the types of activities and communications that would be considered a "recommendation" and subject to a best interest standard.

- Require broker-dealers to disclaim certain forms of firm-level compensation that broker-dealers and/or their affiliates receive for performing customary brokerage services and that are fully disclosed to their customers.

- Create a regulatory preference for compensation plans that are based on sales-commissions and a regulatory presumption against all other forms of rep-level and firm-level variable compensation.

- Apply a best interest obligation to interactions with individuals that have no customer relationship with the broker-dealer and never act on a broker-dealer's recommendations.

- Require broker-dealers to create a confusing estimate of the costs associated with a particular recommendation based on, among other things, projections of holding period, market performance and the customer's tax status during the holding period.

- Promote a patch-work approach to regulation of broker-dealers by encouraging states to consider the Proposal as a "menu" of options from which they can adopt "one, some, or all of the subparts."[4]

Our comments below reflect our concern that the Proposal does not advance its stated goal of defining and clarifying various obligations or components of Reg BI[5] but, rather, would impose an entirely new set of requirements on broker-dealers that are fundamentally at odds with Reg BI. Fidelity also agrees with the concerns expressed in the comment letter submitted by the Securities Industry Financial Markets Association ("SIFMA") on December 4, 2023 (the

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[3] *See* "Regulation Best Interest: The Broker-Dealer Standard of Conduct," Final rule, Release No. 34-86031 ("Reg BI Adopting Release"); File No. S7-07-18, available at https://www.sec.gov/rules/final/2019/34-86031.pdf, (Fidelity comments available at https://www.sec.gov/comments/4-606/4606-3117.pdf).

[4] Proposal, section III.

[5] Proposal, *supra* note 2, at 1.

"SIFMA Letter") and SIFMA's detailed review of the many substantial differences between the Proposed Rule and Reg BI. Because of our longstanding commitment to delivering best-in-class services and a diverse offering of financial products to our customers, we are particularly concerned that the Proposal will have significant negative consequences by reducing customer access and choice. Specifically, because it would be impracticable and likely impossible for broker-dealers to maintain, at scale, different websites and servicing models that vary depending on where the customer lives, works or is serviced from, broker-dealers would be unable to make available to customers free robust websites, digital research tools, factual financial information and other resources. As a result, if adopted, the Proposal would lead to customers having less access to financial education and guidance and fewer choices. Accordingly, we urge NASAA to withdraw the Proposal.

I. THE IMPORTANCE OF PRESERVING CUSTOMER CHOICE

Fidelity's customers rely on the education and guidance we offer to help them make informed investing decisions. We support customers making better, more educated decisions through our interactions with them, with robust and interactive websites, tools and straightforward insights from our experienced professionals. In addition to online tools and information, Fidelity services its customers through more than 200 investor centers located throughout the United States. Fidelity also maintains a significant business presence in the following states: Colorado, Florida, Kentucky, Massachusetts, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Rhode Island, Texas, and Utah.

Fidelity, like many other financial service providers, offers two relevant types of accounts from which retail investors may choose:[6] advisory (or "managed") accounts and brokerage accounts. These accounts differ in material ways, including with respect to fee structures and trading authority. Advisory accounts are generally more appropriate for investors who seek ongoing advice or discretionary portfolio monitoring. Brokerage accounts, on the other hand, are often most appropriate for self-directed investors who prefer to manage their own portfolios and require only incidental advice from time to time.

An investor's investment portfolio, need for brokerage and advice services, and preferred fee structure for those services can vary over time. For example, an investor may seek advice when starting a college savings fund or changing jobs and may be interested in receiving advice at that point in time only. In a brokerage account model, customers can receive that sort of advice without charge; if the customer then decides to act on the advice and execute securities trades, she would incur only costs, if any, associated with the securities trade(s).[7] On the other hand, customers may prefer to have their portfolio managed by a team of professionals, who monitor the market, their investments, and their investing needs, and make and implement trading decisions on their behalf. Investors often have both types of accounts: a brokerage account for

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[6] Fidelity also offers non-retirement, retirement, Health Savings Accounts, 529 college savings, etc. However, the most relevant impacts of the Proposal are to the general classifications of brokerage and advisory accounts.

[7] Fidelity does not charge transaction fees for online trades in equity securities, exchange traded funds and offers a variety of mutual funds without a fee.

some of their assets, and a discretionary advisory account with ongoing asset-based fees for others. Fidelity believes that there are benefits to both types of accounts and that it is imperative to preserve that choice for investors.

The SEC's formulation of Reg BI was guided, in significant part, by the recognition that preserving customer access to both models was critical. As the SEC noted in its release of Reg BI, "we believe that our approach in adopting Reg BI will best achieve the Commission's important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of investment services and securities."[8] Preserving investor choice should be similarly paramount to NASAA and state securities regulators in considering model state regulations.

II. CLEAR AND CONSISTENT STANDARDS OF CONDUCT PRESERVE CUSTOMER CHOICE

It has long been Fidelity's view that broker-dealers and investment advisers should act in retail investors' best interest, and that a clear and consistent standard embracing this obligation would benefit both retail investors and the financial services industry. Through Reg BI, the SEC has developed consistent standards of conduct for broker-dealers across account types and services. In fact, we believe there is no meaningful difference between Reg BI's standard of conduct for broker-dealers and the fiduciary standard for investment advisers – both require that, when making a recommendation, the customer's interests must always come first.

In our view, Reg BI establishes an effective framework for broker-dealers to address potential conflicts of interest and significantly advances the goal of ensuring that retail investors understand their broker-dealers' fees, services, conflicts and obligations. Reg BI imposes a practical standard of conduct tailored to the brokerage model that we believe significantly enhance the obligations already applicable to broker-dealers under the Securities Exchange Act of 1934, as amended ("Exchange Act"), and FINRA's rules, as well as the common law of agency and trust forming the foundation of the federal securities laws.[9] For certain investors, the Employee Retirement Income Security Act of 1974 ("ERISA") imposes fiduciary duties when a broker-dealer provides investment advice to a plan participant regarding plan assets and similar rules apply with respect to recommendations of investments in individual retirement accounts.

In addition to Reg BI, broker-dealers must comply with extensive obligations that are designed to promote conduct that, among other things, protects investors from abusive practices[10]

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[8] *See* Reg BI Adopting Release, *supra* note 3, at 636.

[9] *See* "Regulation Best Interest," Proposed Rule, Release No. 34-83062; File No. S7-07-18, available at https://www.sec.gov/files/rules/proposed/2018/34-83062.pdf.

[10] *See* Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice; Release Nos. 34-92766; IA- 5833; File No. S7-10-21 RIN 3234-AN00 at p. 27 (Aug. 27, 2001); available at https://www.sec.gov/files/rules/other/2021/34-92766.pdf.

including broad anti-fraud provisions within the federal securities laws and regulations that prohibit manipulative or deceptive conduct.[11] These obligations also subject broker-dealers and investment advisers to rigorous internal and external auditing standards. Broker-dealers must "deal fairly with their customers and observe high standards of commercial honor and just and equitable principles of trade,"[12] while investment advisers, as fiduciaries, owe their customers a duty of care and a duty of loyalty.[13] Consistent with the regulations mentioned above, the existing NASAA Broker-Dealer Model Rule also requires broker-dealers to, among other things, maintain high standards and just and equitable principles of trade in the conduct of their business.[14]

The Proposed Rule, however, would bring an end to the generally consistent regulatory framework that applies to broker-dealers and investment advisers. Broker-dealers would be required to comply with a difficult, if not impossible, standard of conduct set forth in the Proposed Rule. The Proposal will also likely disincentivize broker-dealers from investing in websites, technology tools and access to free investment education and guidance and ultimately reduce investors' access to information when making important financial decisions.

To comply with the Proposed Rule, broker-dealers would need to adopt different service models and methodologies for delivering investment advice, education and guidance that are different from state-to-state depending on where the retail customer lives, the state in which the broker-dealer representative servicing the customer is located and, in some cases, the state where the customer works.[15] We believe that broker-dealer regulations that are inconsistent from state to state (depending on which states adopt all or part of the Proposed Rule) and the

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[11] *See* also Securities Act section 17(a), 15 U.S.C. 77q(a); Exchange Act section 10(b), 15 U.S.C. 78j(b); Exchange Act section 15(c), 15 U.S.C. 78o(c); Investment Advisers Act of 1940 ("Advisers Act") section 206, 15 U.S.C. 80b-6; see also Exchange Act section 9(a), 15 U.S.C. 78i(a); see also Basic v. Levinson, 485 U.S. 224, 239 n.17 (1988).

[12] *See*, e.g., Duker & Duker, Exchange Act Release No. 2350, 6 S.E.C. 386, 388 (Dec. 19, 1939) (Commission opinion) ("Inherent in the relationship between a dealer and his customer is the vital representation that the customer be dealt with fairly, and in accordance with the standards of the profession."); see also U.S. Securities and Exchange Commission, Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, at 238 (1st Sess. 1963) ("An obligation of fair dealing, based upon the general antifraud provisions of the Federal securities laws, rests upon the theory that even a dealer at arm's length impliedly represents when he hangs out his shingle that he will deal fairly with the representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of [FINRA's] Rules, with particular emphasis on the requirement to deal fairly with the public.").

[13] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019) [84 FR 33669, 33671 (July 12, 2019)] ("IA Fiduciary Duty Interpretation") (internal quotations omitted). This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own.

[14] *See* NASAA Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule (adopted May 23, 1983; amended May 16, 2022) ("[e]each broker-dealer and agent shall observe high standards of commercial honor and just and equitable principals of trade in the conduct of their business").

[15] Fidelity provides brokerage services to participants in employer sponsored 401(k) and similar workplace savings plans including education and guidance regarding IRA roll-over options, required minimum distribution requirements, and other retirement account related brokerage services.

variation in broker-dealer service models, disclosures and advice that are required to comply with the patchwork of state laws that would result from the Proposal would have the unintended consequences of increasing customer confusion, reducing the services available to investors and the choices they have to manage their assets.

This adverse impact on investor choice is exactly the result that the SEC took care to avoid in adopting Reg BI. The SEC specifically noted that any standard of conduct that was not specifically tailored to the structure and characteristics of the broker-dealer business model and built upon existing obligations that apply to broker-dealers, including FINRA rules "would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations."[16] Accordingly, we urge NASAA to reconsider the need for a state-specific regulation that differs from Reg BI.

III. IMPOSING A BROAD DEFINITION OF WHAT CONSTITUTES A RECOMMENDATION WOULD HARM CUSTOMERS

The Proposal purports to "acknowledge and incorporate by reference" Reg BI and "define and clarify various obligation or components" of Reg BI.[17] The Proposal, however, does not incorporate by reference any specific sections of Reg BI and, instead, proposes a new regulatory framework for broker-dealers that goes well beyond Reg BI. In several cases, the Proposal includes new rules that are directly contrary to Reg BI and incorporates concepts that were considered and expressly rejected by the SEC in the adopting release for Reg BI.

For example, the SEC expressly rejected including a definition of the term "recommendation" in Reg BI reasoning that "the determination of whether a broker-dealer has made a recommendation that triggers application of Reg BI should turn on the facts and circumstances of the particular situation and therefore, whether a recommendation has taken place *is not susceptible to a bright line definition* (emphasis added)."[18] NASAA also noted in the Proposal that what constitutes a recommendation "is a well-established concept with sufficient elasticity to accommodate technology advancements within the industry."[19]

Indeed, the financial services industry has operated for decades under a framework that uses guiding principles offered by FINRA and the SEC to determine under what circumstance a particular communication might be considered a recommendation.[20] In particular, those

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[16] Reg BI Adopting Release, *supra* note 3, at 19.

[17] Proposal, *supra* note 2, at 1.

[18] Reg BI Adopting Release, *supra* note 3, at 79; *see also* page 81 ("We believe that what constitutes a recommendation is highly fact-specific and not conducive to an express definition in the rule text.").

[19] Proposal, *supra* note 2, at 6.

[20] *See* FINRA Rule 2111 (Suitability) FAQ available at https://www.finra.org/rules-guidance/key-topics/suitability/faq.

principals provide that a recommendation will be more likely to have occurred where, among other things, a broker-dealer communication could reasonably be viewed by a customer to include a call to action and the communication was individually tailored to a specific customer's unique circumstances.

In the Proposal, NASAA ignores the SEC's caution that a recommendation is "not conducive to an express definition in the rule text",[21] and offers up an expansive definition of what constitutes a "recommendation" that is contrary to SEC and FINRA guidance. Specifically, the Proposed Rule provides that a broker-dealer will be deemed to have made a recommendation if:

> "the broker-dealer or agent utilized *any means, method or mechanism to feature or promote* an account type, specific security or investment strategy to a retail customer, *whether directly or through a third-party*, then that transaction will not be deemed an unsolicited transaction, but rather *will be deemed a recommendation* (emphasis added)."[22]

By dramatically expanding the concept of what constitutes a recommendation to include any communication that "*features*" or "*promotes*" a security or investment strategy, the Proposed Rule would likely require broker-dealers to conduct a best interest analysis for each customer prior to granting that customer access to a firm's website and other digital planning and guidance tools and education materials, and other content that is made generally available to customers.

The practice of highlighting beneficial and factual information to customers could reasonably be read to "feature" a security and accordingly could only be presented if the broker-dealer concluded that the highlighted security or product was in the best interest of every customer viewing those materials (or any prospective customer that may visit the website or view a newspaper advertisement).

More broadly, Fidelity offers several different opportunities for customers to manage their assets, including self-service offerings involving model portfolios, digital-only advisory services, phone-based advisers and dedicated advisers with supporting teams. Those offerings are described in detail on the Fidelity.com website and Fidelity offers online tools to help educate customers about different ways to manage their money. It is difficult to see how this type of information could be presented in a way that would educate customers about their investment options but not "feature" and "promote" those investment options.

The Proposal's novel definition of what constitutes a "recommendation" could negatively impact an exceptionally broad range of brokerage practices and tools that are designed to educate, guide, and help customers make decisions about their investments and finances and would limit the educational and guidance resources that broker-dealers offer to their customers. Other examples

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[21] Reg BI Adopting Release, *supra* note 3, at 81 ("We believe that what constitutes a recommendation is highly fact-specific and not conducive to an express definition in the rule text.").

[22] Proposed Rule, *supra* note 2, subpart 1.d.(5).

of the types of online education and guidance that might be impacted by the Proposal include programs that:

- encourage retail investors, especially young and new retail investors, to plan for their financial futures and to take action to save and invest, increase contributions to retirement accounts and engage in other wealth-building activities;

- notify customers if they are holding a concentrated position, to help ensure they understand the risks of maintaining the position and to identify potential diversification options and strategies; and

- identify customers who open brokerage accounts and deposit cash into their accounts, but then leave the funds uninvested, often on the mistaken assumption that such funds will be automatically invested. In that instance, Fidelity uses digital tools to educate customers on the choices they have if they want to invest their funds.

Educating investors about these types of issues and the choices they have – whether it be opening a retirement account, saving for college, or investment strategies to diversify a portfolio – should be viewed as a positive experience for customers and a public policy goal of state legislators. Under the Proposed Rule, however, all of these beneficial activities likely involve "featuring" or "promoting" investment options and strategies that a customer might consider and, therefore, would likely fall within the expansive and novel definition of what constitutes a recommendation under the Proposed Rule.

What this means for broker-dealers is that before presenting any information, guidance or education (whether via a direct communication or, more generally, through broker-dealer websites and other digital channels and tools) to a customer or prospective customers that "features" or "promotes" an account type, security or investment strategy, the broker-dealer would need to take into account all relevant facts and circumstances about each customer (and prospective customers, for which a broker-dealer would have very little, if any, information). Practically speaking, it would be impossible for broker-dealers to engage in the individualized customer-specific analysis required under the Proposal prior to creating websites and other digital channels that feature or promote financial information and services available to customers. The likely outcome would be that broker-dealers would limit customer access to their websites until the firm considered, as required by the Proposal, "all relevant facts and circumstances" including the customer's "age, education, other investments, debt, financial situations and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance."[23] To comply with the Proposed Rule, broker-dealers would then need to dynamically curate customer-specific web pages for every customer. This is not practical nor is it, in our experience, what customers expect when they are seeking education, guidance and factual information about the financial products, services, securities that enable customers to secure their financial well-being.

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[23] *Id.* subpart 1d(3).

This would be a harmful outcome for investors, particularly for low- and middle- income or first-time investors. Traditionally, there has been no shortage of financial education and guidance available to affluent investors. Firms like Fidelity have been working for years to develop scalable means to bring financial education and guidance to low- and middle-income investors while driving the cost of investing down. Equity trades that just a few decades ago cost hundreds of dollars are now free and investors can easily access through broker-dealer websites an extensive array of education, guidance and planning tools because of the investment that firms like Fidelity have made in developing and building their brokerage infrastructure. Collectively, the mass availability of these technology-driven investing tools coupled with the tremendous decrease in costs have democratized the investing and saving process for all Americans, regardless of their age or wealth. The Proposed Rule's expansive definition of what constitutes a recommendation threatens to not only limit future progress in democratizing saving and investing, but also to unwind much of the progress made to date.

IV. OTHER SPECIFIC FLAWS

In addition to the expansive and unworkable definition of what activity would be considered a "*recommendation*", the Proposal suffers from several additional defects that would make it difficult, and, in key respects, impossible for broker-dealers to continue to provide brokerage advice, guidance and education. Many of these problems are described in more detail in the SIFMA Letter. We agree with the views expressed in the SIFMA Letter and offer additional feedback below.

A. Compensation

Any compensation plan can create incentives for broker-dealers or their representatives to behave in a certain way regardless of how the plan is structured and it is the broker-dealer's obligation to ensure that compensation plans do not create improper incentives to act in ways that are not in the customer's best interest. In adopting Reg BI, the SEC acknowledged that certain types of compensation programs are more likely to create an incentive for a representative to offer investment advice that is not in the best interests of her customers. To address this concern, the SEC took a reasoned approach and identified specific types of compensation arrangements that result in conflicts of interest that are so pervasive that "they cannot be reasonably mitigated and must be eliminated in their entirety."[24] Specifically, Reg BI requires broker-dealers to eliminate sales contests, sales quotas and similar arrangements that involve time-bound compensation and are limited to a specific period of time because they "create high-pressure situations for associated persons to engage in sales conduct contrary to the best interest of retail customers."[25] Importantly, the SEC noted that compensation arrangements that are not expressly prohibited are permitted "provided that the broker-dealer establishes

[24] Reg BI Adopting Release, *supra* note 3, at 351-352.

[25] *Id.* at 351.

reasonably designed policies and procedures to disclose and mitigate the incentive created" and complies with its other obligations under Reg BI.[26]

Inexplicably, the Proposal takes this concept from Reg BI that was narrowly focused on compensation practices that were time-bound and created "high pressure situations" and proposes a compensation rule that provides:

> "The broker-dealer or agent will be presumed to have placed its financial interest ahead of the interest of the retail customer where the broker-dealer or agent [. . .] rewards the *broker-dealer or agent with additional cash or non-cash compensation beyond the sales commission as the result of that recommendation.*" (emphasis added)[27]

This broad and expansive regulatory presumption that all forms of variable compensation (other than sales commissions) that result from a recommendation are contrary to a broker-dealer's obligations to customers effectively prohibits the broker-dealer from receiving, or paying its representatives, any form of variable compensation (other than sales commissions) even though such compensation arrangements are expressly permitted by under Reg BI. In the Proposal, NASAA explains that it is permitting sales commissions because they are "inherent to the broker-dealer model (and consequently cannot be avoided or eliminated altogether, but which can be mitigated)."[28] Although the payment of sales commissions may be common, there is no public policy reason or benefit to customers that could result from codifying a regulatory presumption in favor of sales commissions.

Establishing a regulatory presumption in favor of sales commissions, we believe, would ultimately harm customers by creating a strong incentive for a broker-dealer representative to promote securities transactions and that earn the highest sales commissions rather than engage in more a more wholistic understanding of the customer's needs and the types of financial services that may be appropriate for that customer. Because representatives often service regions that include more than one state, it would be difficult or impossible to structure and administer state-specific compensation plans. In the adopting release, NASAA acknowledges that the incentives that result from compensation plans that are based on sales commissions can be mitigated. NASAA should acknowledge that any conflicts associated with other forms of variable compensation can also be mitigated (as the SEC expressly acknowledged in the Reg BI adopting release).

In addition to requiring a broad restructuring of representative compensation plans in favor of sales commission based models, the expansive language of the Proposed Rule would seem to require a wholesale restructuring of customary and often highly-regulated sources of revenue that broker-dealers or their affiliates receive in connection with the custody and administration of assets on the brokerage platform and other customary brokerage services. Examples of these forms of variable compensation include 12b-1 fees paid by mutual funds for shareholder

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[26] *Id.* at 356.

[27] Proposed Rule, *supra* note 2, subpart 1.d.(2).b.

[28] *Id.* at 4.

servicing and distribution activities, mark-ups and mark-downs in connection with the sale of fixed income securities, payments that broker-dealers received from banks related to FDIC sweep programs and the management fees that broker-dealer affiliates receive for managing proprietary mutual funds among other sources of revenue.

Taken literally, the NASAA Proposal would seem to offer the following choice to broker-dealers: either limit all forms of variable compensation to only sales commissions or attempt to overcome the "presumption" that any other form of compensation paid or received is in violation of the broker-dealer's obligations to customers.

B. Mitigation of Firm-Level of Conflicts of Interest

The Proposal's requirements applicable to a broker-dealer's obligations with respect to conflicts of interest are also in conflict with Reg BI and would create obligations that would likely be impossible to comply with. Specifically, the language in the Proposed Rule provides that broker-dealers "must make all reasonable efforts to avoid or eliminate conflicts of interest. Conflicts of interest that cannot reasonably be avoided or eliminated must be disclosed and mitigated" and then defines "mitigation" to mean "neutralizing or reducing the potential for harm or adverse impact of the conflict."[29] The SEC, however, expressly elected not to mandate the avoidance, reduction, neutralization and/or elimination of any particular conflict because it was concerned that there are some conflicts that are beyond the control of the broker-dealer or its agent or maybe unknown to the representative. This is particularly true of firm-level conflicts: compensation or fees that are earned by the broker-dealer or its affiliates for performing customary brokerage services in the administration and custody of accounts and assets and in connection with activities such as management fees for managing proprietary investment products. As the SEC noted when adopting Reg BI: "[w]e are persuaded by commenters regarding the competitive issues for broker-dealers that could arise if we require mitigation of firm-level financial incentives, which is not required by an investment adviser's fiduciary duty, and could further encourage migration from the broker-dealer to investment adviser model and result in a loss of choice for retail customers."[30]

The rigid approach included in the Proposal would likely result in the very harm that the SEC was trying to avoid, namely the reduction in the choices available to customers. In adopting Reg BI, the SEC recognized that there are certain unavoidable conflicts inherent in the brokerage business model.[31] These conflicts primarily arise because broker-dealers sell a variety of proprietary and third-party products with fundamentally different cost structures and fees, as well as products primarily sold on a principal basis (e.g., underwritten securities, including municipal bonds). Accordingly, Reg BI permits broker-dealers to use full and fair disclosure to mitigate conflicts where appropriate. NASAA, however, explicitly states that the disclosure of conflicts alone would not suffice under its fiduciary requirements and would expressly require that a broker-dealer "avoid", "eliminate", "neutralize" or "reduce" every conflict. This requirement not

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[29] Proposed Rule, *supra* note 2, subpart 1.d.(1).

[30] Reg BI Adopting Release, *supra* note 3, at 328.

[31] *Id.* at 7.

only conflicts with Reg BI, but also would impose a substantially higher duty than is required under the Investment Advisers Act, which allows fiduciary investment advisers to manage conflicts of interest through customer disclosures and informed consent.

C. Other Flaws

In addition to the significant flaws in the Proposal outlined above, the Proposed Rule would impose other novel requirements on how broker-dealers interact with their customers and prospective customers. Many of these are discussed in more detail in the SIFMA Letter; we agree with the views expressed in that letter and will only address them briefly here:

- *Expanded definition of costs*. The Proposed Rule takes a general discussion of costs in an SEC staff bulletin[32] and proposes to "elevate" that language into a regulatory obligation that would require broker-dealers consider the *"the sum total of all potential fees and costs based on the anticipated holding period for the security or investment strategy that is recommended by the broker-dealer or agent."* In contrast, Reg BI provides for the disclosure of "material" costs and requires the "exercise of reasonable diligence, care and skill to understand costs and consider the costs"[33] when making a recommendation. Importantly, the term "costs" is not defined in Reg BI reflecting an implicit acknowledgement that what costs are relevant will depend on what investment strategy, account type or security is being recommended. The Proposed Rule, however, abandons this approach and would require a broker-dealer to project the "sum total" costs for holding a security over some assumed holding period (requiring, it would seem, projections of market performance, tax considerations and the market performance of individual securities). It is not clear on what basis or assumptions a broker-dealer would make these projections and any projected costs would be only as good as the accuracy of those projections. In addition to not being practical, explaining these types of cost projections to customers would likely cause confusion and be of little value given the assumptions that would need to be made to calculate the projected costs.

- *Definition of Retail Customer.* Reg BI defines retail customer as "a natural person . . . who . . . [u]ses the recommendation primarily for personal, family, or household purposes."[34] In the adopting release of Reg BI, the SEC expressly stated that "we would like to clarify that the definition of 'retail customer' does not apply to prospective customers who do not receive and use a recommendation from a broker-dealer" and that the SEC "intended to exclude recommendations related to commercial or business purposes."[35] The Proposal, however, takes the exact opposite position and states that "the term 'retail customer' shall *include* current and prospective customers (emphasis

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[32] *See* Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations, modified April 20, 2023 https://www.sec.gov/tm/standards-conduct-broker-dealers-and-investment-advisers.

[33] Exchange Act rule 15l-1(a)(2)(ii).

[34] Reg BI Adopting Release, *supra* note 3, at 124.

[35] *Id.* at 108.

added)."[36] Further, the Proposed Rule is not limited to natural persons and would appear to apply to any natural person or entity that does not fall within one of the narrow carve-outs for institutional investors. Again, without explanation or commentary other than a generalized statement that this section is intended to provide "greater regulatory certainty regarding a key term." The Proposed Rule's definition of "retail customer" is unnecessarily vague, would create uncertainty about the scope of the Proposed Rule and is simply impracticable to apply a best interest analysis to individuals who are not yet customers. Indeed, the term "prospective customer" could be interpreted to mean any person who visits a firm's website, social media account or that is exposed to the firm's advertising and marketing. We do not believe this is practical or serves any public policy interest to impose a best interest obligation on broker-dealers who feature or promote their products on public facing website or marketing materials both of which are already subject to extensive regulation under SEC and FINRA rules.

- *Recommendations through a third party.* The Proposed Rule's overbroad and ambiguous definition of recommendation encompasses communications "through a third-party."[37] This aspect of the definition raises the question of whether a broker-dealer's interactions with its intermediary clients - third party registered broker-dealers and registered investment advisers - would be in scope. In the institutional brokerage model, Fidelity interacts with its intermediary clients, who in turn, interact with their customers. Intermediary clients may learn information from Fidelity about product offerings and recommend those products to their customers based on their own understanding of their customers' investment objectives and risk profile. It would be unreasonable to view these recommendations by regulated entities - who are subject to their own best interest and fiduciary obligations - as Fidelity's recommendations, subject to the proposed rule.

V. CONSUMERS FROM EVERY STATE WOULD BE IMPACTED BY THE PROPOSAL

Because of the Proposal's far-reaching changes to the operations of impacted broker-dealers, it would be almost impossible for broker-dealers to create, implement and maintain state-specific business and operations practices and related compliance policies and procedures that are unique to the individual states that adopt some or all of the Proposed Rule. In addition, customers are often serviced by a broker-dealer representatives that is located in another state from where the customer resides. In situations where a retail customer resides in one state, works in another state and is serviced by a broker-dealer representative that is located in a third state, it would seem that, if any of those states adopted all or part of the Proposed Rule, the broker-dealer would need to ensure that interactions with that customer complied with the model rule in its entirety, to ensure compliance in all three states. In those situations, the broker-dealer would face the undesirable choice of maintaining a uniform broker-dealer service model and reduce access to its website, advice and guidance tools and resources for all customers regardless of the state in

[36] Proposal Rule, *supra* note 2, subpart 1.d.(6).

[37] Proposal, subpart 1d(5).

which they reside, work or are serviced from or attempt to offer different levels of investment advice, guidance and education on a state-by state basis.

This challenge is further compounded by the Proposal's statement that the statutory provisions should be considered a "menu" from which states can pick and choose "one, some, or all" of the subparts of the Proposed Rule. This invitation for states to adopt different versions of the Proposal would create a regulatory landscape for broker-dealers that requires compliance with inconsistent and often conflicting state and federal standards of conduct but also variation among the states that have adopted different parts of the Proposed Rule. This lack of uniformity is directly the contrary of what model rules are intended to achieve.

VI. CONCLUSION

Fidelity supports NASAA's interest in protecting customers from decisions not made in an investor's best interests. However, investment advice provided to retail customers is already regulated by Reg BI and other SEC and FINRA rules and the existing NASAA Broker-Dealer Model Rule. In seeking to further address this issue by radically overhauling the requirements of Reg BI, the Proposal would likely result in a reduction in education guidance and information needed by customers to save and invest on their own terms Additionally, the existing NASAA Broker-Dealer Model Rule also requires broker-dealers to, among other things, maintain high standards and just and equitable principles of trade in the conduct of their business providing a clear and consistent standard that benefits both retail investors and the financial services industry. In sum, the harm that would be caused by the Proposal outweighs any potential benefit that NASAA believes will come from the Proposal.

We encourage NASAA to withdraw the Proposal.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts NASAA undertakes, or respond to questions NASAA may have about our comments.

Sincerely,

Charles H. Sturdy

Charles H. Sturdy
Chief Legal Officer
Fidelity Brokerage Services LLC

cc: Amy Kopelton, Broker-Dealer Market and Regulatory Policy and Review Project Group Chair
Stephen Bouchard, Broker-Dealer Section Chair