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July 26, 2019

The Honorable Mike Crapo
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Maxine Waters
Chairwoman
The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Regulation Best Interest: The Broker-Dealer Standard of Conduct*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission) entitled “Regulation Best Interest: The Broker-Dealer Standard of Conduct” (RIN: 3235-AM35). We received the rule on June 7, 2019. It was published in the *Federal Register* as a final rule on July 12, 2019. 84 Fed. Reg. 33318. The effective date of the rule is September 10, 2019.

The Commission stated the final rule establishes a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities. The Commission further stated the final rule enhances the broker-dealer standard of conduct beyond existing suitability obligations and aligns the standard of conduct with retail customers’ reasonable expectations by requiring broker-dealers, among other things, to: (1) 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 ahead of the interests of the retail customer; and (2) address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where it has been determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict. The Commission also stated the standard of conduct in the final rule draws from key principles underlying fiduciary obligations, including those that apply to investment advisers under the Investment Advisers Act of 1940. Importantly, according to the Commission, regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment advisor) that is in the best interest of the retail investor and that does not

place the interests of the firm or the financial professional ahead of the interests of the retail customer.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Janet Temko-Blinder, Assistant General Counsel, at (202) 512-7104.

signed

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Vanessa Countryman
Acting Secretary
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
“REGULATION BEST INTEREST:
THE BROKER-DEALER STANDARD OF CONDUCT”
(RIN: 3235-AM35)

(i) Cost-benefit analysis

The Securities and Exchange Commission (Commission) stated the final rule contains several different obligations, and each obligation has its own costs and benefits. Key examples from each obligation follow. The Commission stated the “Disclosure Obligation” would create costs for broker-dealers by having to evaluate their continued use of the title adviser and advisor as well as any rebranding for any business using those terms in its name or materials. The Commission also stated broker-dealers will incur costs in assessing potential conflicts of interest on a case-by-case basis, preparing disclosure materials, and documenting when disclosures occur. Overall, the Commission estimated the “Disclosure Obligation” will impose an initial aggregate cost of \$1,508.88 million and ongoing annual costs of \$499.59 million. Also, the Commission stated the “Care Obligation” may require broker-dealers to stop offering certain products, which could lead to a loss of revenue. The Commission also stated the obligation could lead to increased retail customer arbitration or litigation. Next, the Commission stated the “Conflict of Interest Obligation” would impose costs on broker-dealers as they expend resources to identify current and potential conflicts of interest and periodically review and update their procedures to account for new conflicts and circumstances. The Commission also stated broker-dealers may have to stop offering certain products and forgo revenues to comply with the obligation. The Commission estimates the obligation would impose an initial aggregate cost of \$110.73 million and an ongoing aggregate annual cost of at least \$20.44 million on broker-dealers. Also, the Commission stated the “Compliance Obligation” would impose training as well as other costs on broker-dealers. The Commission estimated the obligation would impose an initial aggregate cost of \$214.66 million and an ongoing aggregate cost of \$110.86 million on broker-dealers. Finally, the Commission estimated the “Record-Making and Recordkeeping Obligations” would impose an initial aggregate burden of \$375,732 and 17,684,020 hours as well as an ongoing aggregate annualized burden of 5,520,800 hours. After monetizing the burden hours, the Commission estimates the obligation imposes an initial aggregate cost of \$4,121.73 million and an ongoing aggregate annual cost of \$7,736.52 million.

The Commission stated the “Disclosure Obligation” would benefit retail customers by making them aware of the capacity in which a broker-dealer is acting, which will allow them to better evaluate the advice they receive. The Commission also stated this obligation would allow investors to seek an advisory relationship if desired and focus their attention on any potential conflicts of interest, amongst other benefits. Also, the Commission stated the “Care Obligation” would benefit customers by reducing the incidence of high-cost investment recommendations when there are reasonable alternatives. The Commission further stated the obligation will increase recommendation efficiency and enhance investor protection. Next, the Commission stated the “Conflict of Interest Obligation” would benefit retail customers by reducing information asymmetry between the customer and the broker-dealer and reduce the effect of incentives posed by these conflicts. Also, the Commission stated the “Compliance Obligation” would

indirectly benefit retail customers by ensuring broker-dealers have in place sufficient internal controls.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Commission stated it prepared a Final Regulatory Flexibility Analysis in accordance with the provisions of the Act. The analysis included (1) a statement of the need for and objectives of the final rule; (2) a description of issues raised by public comments; (3) a description of small entities subject to the rule; (4) projected reporting, recordkeeping, and other compliance requirements; and (5) a description of the Commission's actions to minimize effects of the rule.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551*et seq.*

On May 9, 2018, the Commission published a notice of proposed rulemaking. 83 Fed. Reg. 21574. The Commission further stated it received over 6,000 comment letters in connection with the proposed rule, of which approximately 3,000 were unique comments letters. The Commission stated the comments came from a variety of sources including individual investors, consumer advocacy groups, financial services firms (including broker-dealers, investment advisers, and insurance companies), investment professionals, industry and trade associations, state securities regulators, bar associations, and others. The Commission also stated it solicited individual investors' input through a number of forums and also hosted seven investor roundtables and received in-person feedback from 200 attendees. The Commission responded to comments in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The Commission determined the final rule contains information collection requirements (ICR) under the Act. The Commission stated the ICRs were submitted to the Office of Management and Budget (OMB) for review. The ICRs include "Regulation Best Interest," "Records to be made by certain exchange members, brokers and dealers" (OMB Control No. 3235-0033), and "Records to be preserved by certain exchange members, brokers and dealers" (OMB Control No. 3235-0279).

Under the final rule's "Disclosure Obligation," the Commission estimates broker-dealers will incur an aggregate total initial burden of 6,216,125 hours and a total initial cost of \$42.84 million as well as an aggregate total ongoing annual burden of 2,101,493 hours to comply with the related ICRs.

Under the final rule's "Conflict of Interest Obligation," the Commission estimates broker-dealers will incur an aggregate total initial burden of 197,310 hours and a total initial cost of \$40.71 million as well as an aggregate total ongoing burden of 55,560 hours and \$2.91 million to comply with the related ICRs.

Under the final rule's "Compliance Obligation," the Commission estimates broker-dealers will incur an aggregate total initial burden of 524,414 hours and a total initial cost of \$71.4 million as well as an aggregate total ongoing burden of 463,588 hours and \$2.91 million to comply with the related ICRs.

Under the final rule's record-making obligations, the Commission estimates broker-dealers will incur an aggregate total initial burden of 4,084,020 hours and a total initial cost of \$375,732 as well as an aggregate total ongoing annual burden of 1,060,000 hours to comply with the related ICRs.

Under the final rule's recordkeeping obligation, the Commission estimates broker-dealers will incur an aggregate total initial burden of 13,600,000 hours as well as an aggregate total ongoing annual burden of 4,460,000 hours to comply with the related ICRs.

Statutory authorization for the rule

The Commission stated it promulgated the rule under section 913(f) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1827, as well as 15 U.S.C. §§ 78c, 78j, 78o, 78q, 78w, and 78mm.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the Order.