ANALYSIS OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION'S (NASAA) REG BI SURVEYS

Prepared by Greenwald Research

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EXECUTIVE SUMMARY

The North American Securities Administrators Association's (NASAA) Regulation Best Interest (Reg BI) Implementation Committee (Committee) conducted two surveys with the stated purpose of measuring the impact of the U.S. Securities and Exchange Commission's (SEC) Reg BI and level of compliance with the regulation. While any effort to measure the effect of public policy is laudable, a careful review of the Committee's research effort uncovered significant deficiencies, including the notable failure to follow eight well-established and critical survey research practices. The flaws in the design and execution of this research mean that its findings and conclusions cannot be relied upon as accurate measures of firm behavior, compliance with Reg BI, the impact of the regulation, or the extent to which the interests of investors are well-served.

Survey research is a mature field, with several well-accepted standards and codes of conduct that have been recognized for decades. Among these standards and codes of conduct are:

1. Questions must be aligned with each survey's research objective.
2. Questions must be clear and understandable to ensure that every respondent knows what is being asked and each respondent's answer is based on the same understanding.
3. Answer categories must allow each respondent to accurately report his or her answer.
4. A questionnaire and analysis must be objective and without a pre-determined agenda or effort to obtain a specified result.
5. An effort to measure the impact of an event or change, such as the impact of Reg BI, must: 1) include clear before and after measures, 2) demonstrate causality, and 3) eliminate plausible rival explanations.
6. Sampling of a population must be designed to achieve an accurate measurement of the characteristics of the entire population to which it is applied.
7. Any report of a survey must include detailed information about sampling and associated methodology to allow readers to evaluate this crucial component of the survey process.
8. The results of a survey must be reported accurately and not mischaracterized.

The attached report by Greenwald Research, an established expert in research and survey methodology, points out numerous instances in which these standards were not met. The analysis also found that the surveys failed to collect information on key actions firms have taken that are pertinent to Reg BI and the best interests of their clients. As a result, the conclusions reached by the Committee are not supported by the information gathered in the surveys and should not be considered as a basis for action by the SEC or other policymakers. Any attempt to realistically assess the impact of Reg BI and its impact on investors and investment products to achieve NASAA's stated research purpose would require a completely new survey or other type of analysis.

GREENWALD RESEARCH

Dr. Mathew Greenwald[1] is a recognized expert in survey research, with particular expertise in survey research involving investors, financial professionals, and executives in financial service companies, including broker-dealers and investment advisers. He led the analysis for Greenwald Research that resulted in this report. In his 36 years at Greenwald Research, Dr. Greenwald has conducted over 500 major national surveys of investors, financial professionals, and executives of financial services firms and tens of thousands of interviews and focus groups. He has supervised thousands of surveys, interviews, and focus groups conducted by associates of his firm. Dr. Greenwald has also conducted many studies on the issue of investment-related disclosures to investors, including the effectiveness of disclosures regarding complex financial products. He was trained in survey methodology at Rutgers University, where he earned a Ph.D. in sociology. A summary of Dr. Greenwald's background in this subject area is set forth in Appendix I.

[1] Mathew Greenwald, Greenwald Research, January 5, 2022, available at https://greenwaldresearch.com/.

ANALYSIS OF NASAA AND RELATED MATERIALS

The North American Securities Administrators Association's (NASAA) Regulation Best Interest (Reg BI) Implementation Committee (Committee) undertook a research effort with the stated purpose of measuring the impact of the U.S. Securities and Exchange Commission's (SEC) Reg BI and level of compliance with the regulation. The Committee sought to understand the extent to which broker-dealers have changed their policies, procedures, and practices in response to its adoption. In connection with this effort, the Committee conducted two surveys of broker-dealers and investment advisers and produced reports covering the findings of each survey. Questionnaires were sent to broker-dealers and investment advisers as formal requests for information by 34 states that are NASAA members. Recipients were required to respond.

At the request of a group of trade associations whose members serve millions of investors,[2] Greenwald Research conducted a detailed analysis of the questionnaires, the reports on the findings, and other pertinent material.[3] As part of this review, in-depth cognitive interviews were conducted with senior staff from nine firms that responded to the questionnaires, representing large, medium and small firms.[4] For purposes of this report, the two Committee reports and questionnaires will be referred to as "Phase I" and "Phase II."

After a careful review of information collected, Greenwald Research has concluded that the questionnaires, survey processes, and resulting reports failed to follow eight widely-accepted survey research standards and best practices listed below.[5] As a result, the information obtained from the surveys and the conclusions set forth in the reports cannot and should not be relied upon as an accurate measure of whether broker-dealers and investment advisers are complying with the terms of Reg BI or if additional regulatory action is warranted.

This report describes how the survey authors failed to follow those applicable standards in key areas. Appendix II provides additional examples of deficiencies not included in the main body of this report.

[2] In alphabetical order, Alternative & Direct Investment Securities Association (ADISA), American Council of Life Insurers (ACLI), American Securities Association (ASA), Financial Services Institute (FSI), Institute for Portfolio Alternatives (IPA), Insured Retirement Institute (IRI), National Association for Fixed Annuities (NAFA), National Association of Insurance and Financial Advisors (NAIFA), 50 NAIFA State Chapters, Nareit, Securities Industry and Financial Markets Association (SIFMA), Small Business Investor Alliance (SBIA), and U.S. Chamber of Commerce Center for Capital Markets Competitiveness.

[3] NASAA Regulation Best Interest Implementation Committee, Regulation Best Interest, National Examination Initiative Phase One, September 2020 ("Phase I"); Report and Findings of NASAA's Regulation Best Interest Implementation Committee, National Examination Initiative Phase II (A), November 2021 ("Phase II"); NASAA Committee Phase One Questionnaire; NASAA Committee Phase II (A) Questionnaire.

[4] Interview subjects included senior staff at respondent firms which operated as broker-dealers, investment advisers, and dually-registered firms.

[5] Floyd J. Fowler, Jr., Improving Survey Questions: Design and Evaluation, Sage Publications, 1995; Ian Brace, Questionnaire Design: How to plan, structure and write survey material for effective market research, Kogan Page Publishers, 2018.

SURVEY METHODOLOGY

Survey research is a mature field, with several well-accepted standards and codes of conduct, the importance of which has been established for decades. Among these standards and codes of conduct are the following:

1. **Questions must be clear and understandable to ensure that respondents know what is being asked and that the answers of all respondents are based on the same understanding**. A failure to meet this standard leads to responses that cannot be reliably compiled, analyzed, or interpreted. In numerous instances, the questionnaires used terms or phrases that respondents did not understand or interpreted differently. A crucial part of survey research best practices that the Committee appears to have neglected is conducting an evaluation of the questionnaire before the surveys were distributed. One of the most effective ways of doing this evaluation is "cognitive interviewing," in which people in the response pool are asked about the questions to make sure they understand them.[6] The Committee appears to have omitted this key step.

2. **Answer categories must allow respondents to accurately report their answers.** This may require answer categories that include "not sure," "other," and/or inclusion of a comment section which provides respondents an opportunity to answer accurately and completely. If respondents cannot respond fully or accurately with the response categories that are offered, the results of the survey will not be reliable. The questionnaires repeatedly failed to provide answer categories that reflected reasonably anticipated responses. Some states that distributed the surveys informally advised some respondents that they could submit additional detail in supplemental documents, but there is no evidence that these more detailed and accurate responses were integrated into the analysis of the results. Many respondents were not even aware that they could submit supplemental responses to better inform interpretation of the surveys' results.

3. **Questions in any survey must be aligned with its objective.** If a survey has a hypothesis or seeks to measure the extent to which a specific behavior is occurring in a population or the degree to which a specific viewpoint is held, it must ask questions which can fairly test that hypothesis or measure the extent to which the behavior is occurring. If the questions do not provide a fair opportunity to prove or disprove a hypothesis or measure specific behavior, the research cannot meet its objective. The questionnaires had the stated intention of measuring compliance with Reg BI but failed to measure compliance with many of the regulation's key features, and instead inquired about areas unrelated to Reg BI.

4. **For the results of any survey to be considered reliable, the questions must not be premised on a pre-determined agenda or effort to obtain a specific answer**. In several areas, the questionnaires and reports indicate a pre-determined agenda. For example, in many instances, the questionnaires reveal a bias against four enumerated investment products—private securities, non-traded real estate investment trusts (REITs), leveraged or inverse ETFs, and variable

[6] An article by the National Center for Health Statistics recently stated, "Cognitive interviewing is a popular method for evaluating survey questions in the federal government. It offers a detailed depiction of meanings and processes used by respondents to answer questions—which ultimately impact the survey data. As such, the method offers insight that can enhance understanding of question validity and response error." CCQDER - Cognitive Interviewing," Centers for Disease Control and Prevention, National Center for Health Statistics, August 26, 2014, available at https://www.cdc.gov/nchs/ccqder/evaluation/CognitiveInterviewing.htm.

annuities—and indicate a pre-determined effort on the part of the survey authors to discredit those investment products and reduce investor access to them**.**

5. **An effort to measure the impact of an event or change, such as the implementation of Reg BI, must meet three criteria: 1) clear "before" and "after" measurements, 2) the ability to demonstrate causal links, and 3) elimination of other plausible explanations.** The questionnaires failed to address or accomplish any of these criteria.

6. **A survey report must include detailed information about sampling and associated methodology**. Providing this information allows readers to evaluate this crucial component of the survey process. The reports do not include any information about how the sample of respondents was drawn or how the characteristics of the control group in the Phase II survey compared to the sample in the Phase I survey. As a result, the results of the survey cannot be assumed to be accurate.

7. **Sampling of a population must be designed to achieve an accurate measurement of the characteristics of the entire population to which it is applied, and the data should, to the extent possible, be "weighted" to reduce or eliminate any skew in sampling.** The surveys were distributed to a large number of firms that vary widely in size and the number of customers that they serve, but the reports do not take these significant disparities into account. Stated simply, the policies or procedures of a broker-dealer that serves 100 customers should not be afforded the same weight in assessing market impact as those of a firm that serves 1 million customers. Because the survey data were not weighted and the actions of firms that serve relatively few retail clients were afforded the same relative weight as firms that serve thousands of clients, no assessment can be made about the overall impact on investors as a group.

8. **The results of a survey must be reported accurately and not mischaracterize results.** A failure in this regard makes any report and conclusion inaccurate and untrustworthy. The Committee made many statements about the findings that are not supported by the results of their research.

SURVEY ANALYSIS

I. Major Deficiencies in the Analysis and the Report

1. <u>The research sought to, and claimed to, measure the impact of Reg BI, but failed to obtain an accurate measurement of its impact on the respondent firms.</u>

As stated above, to measure the impact of Reg BI, it is incumbent on the surveys to 1) establish clear "before" and "after" measurements, 2) demonstrate what the impact of Reg BI was, and 3) eliminate other possible explanations. Unfortunately, this research did not make any effective effort to address any of these requirements.

Several of the questions in the Phase II questionnaire asked respondents "…whether the requirement was adopted as the result of Regulation Best Interest."[7] Broker-dealers have policies and procedures covering many aspects of their business. These evolve over time in response to customer preference, innovations in product design, regulatory expectations, and other factors. While firms can report on changes in their policies, procedures, and compliance protocols, including when a change was made, there may be multiple reasons for any change in practice or procedure.

Many firms made changes to their policies and procedures when the U.S. Department of Labor (DOL) adopted the Fiduciary Rule[8] in 2016—which had several similarities and overlap with Reg BI—and kept those changes in place even after the Fiduciary Rule was vacated.[9] Some firms made changes when Reg BI was first proposed.[10] Others made additional changes after it was adopted. Still others made changes for a variety of reasons, regulatory and otherwise.

Knowing that, it is unclear what is meant by the phrase "as a result of Regulation Best Interest." If a firm had multiple reasons for taking an action and Reg BI was one of them, it would be difficult to say that the action was taken "as a result" of Reg. BI. Moreover, some firms may already have been complying with requirements of Reg BI before its adoption, but their answers to the survey questions would indicate that no changes were made due to Reg BI. It would be paradoxical at the least if broker-dealers did everything necessary to achieve compliance with Reg. BI, or took actions which accomplished results intended by Reg BI prior to it becoming effective, and yet received no credit in the surveys for having done so. This critical flaw in the methodology has the effect of suggesting that the best actors were in fact the worst actors. Note the following examples:

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[7] See, for example, Phase II questions 34, 36, 38, 40, 42 and 44.

[8] Department of Labor (DOL), Employee Benefits Security Administration (EBSA), "Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption; ... Final rule," 81 Federal Register, April 8, 2016.

[9] As early as February 23, 2015, President Obama called for a major overhaul of the DOL rules, and new regulations were proposed on April 14, 2015. Prior to the Fifth Circuit Court of Appeals' decision to vacate the DOL fiduciary rule, final rulings were issued on April 8, 2016.

[10] Reg BI was first proposed by the SEC on April 18, 2018. It was finalized on June 15, 2019, published in the Federal Register on July 12, 2019, and compliance was required between September 10, 2019 and June 30, 2020.

- A number of questions in the Phase I questionnaire asked about practices in effect between January 1, 2018 and December 31, 2018 or the most recent fiscal year ending in 2018. However, these questions do not consider actions that firms may have taken prior to that time, many of which were substantial.
- Questions 43 and 44 of the Phase II questionnaire asked if the requirement "to educate consumers on the pros and cons of rolling over assets from a workplace retirement account into an IRA or other firm account" was "adopted as a result of Regulation Best Interest." This question has at least two fundamental flaws:
    - Educating consumers about rolling over assets had been an integral part of conversations with financial advisors for many years prior to Reg BI. In fact, the DOL issued guidance on Participant Investment Education[11] as early as 1996, which included having conversations about transferring assets from employer-sponsored retirement savings plans to Individual Retirement Accounts (IRAs). Financial institutions have always discussed the pros and cons of investment decisions with customers. More recently, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 13-45[12], which covers the many factors that should be part of consideration by a client as to whether they should roll over their assets.
    - The meaning of the term "educate consumers" in Questions 43 and 44 in Phase II is not clear and is not likely to be interpreted in the same way by all respondents. The question seems to imply an obligation to "educate" consumers outside the context of providing investment advice or making recommendations with respect to investments or investment strategies. This is confusing at best. Since these obligations only exist in specific circumstances, some respondents did not know how to interpret or answer the question.
- Question 60 in the Phase II questionnaire asks if firms have "…ceased participation in any of the following compensation practices as the result of Regulation Best Interest." As noted above, the meaning of "as the result of Regulation Best Interest" is very difficult to delineate.

The result is a body of research that, at best, failed to measure the real impact of Reg BI and the many major changes that broker dealers and investment advisers have made in the past five years, and at worst, significantly mischaracterizes and misinterprets firm behavior and the drivers of consumer benefit.

2. The questionnaires did not accurately measure compliance with Reg BI and asked about policies not required by Reg BI.

In several areas, the questionnaires asked about policies or procedures that are not required by Reg BI and did not seek to measure compliance with policies that are required by Reg BI. Note the following examples:

[11] Department of Labor Interpretive Bulletin 96-1, 61 CFR 29586 (June 11, 1996).
[12] Regulatory Notice 13-45, December 2013.

- Reg BI requires that disclosures be made at or before the point of an investment recommendation to a customer. However, questions were included about the timing of disclosure at two different and specific points in time: (1) "at the time of the recommendation"[13] and (2) "at the point of sale/advice."[14]
  - The questionnaires often failed to ask about disclosures made before a recommendation, which is the general standard in Reg BI. In some cases, the questionnaires asked about disclosures at a point in time later than the recommendation, which is not required by Reg BI. Cognitive interviews with respondents indicated that many were confused by the "point of sale/advice" language, especially as the actual point of sale can come days, weeks, or even months after the time of the recommendation. The lack of temporal clarity made this question difficult to understand, which resulted in unreliable responses.
  - The Phase II report states that "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."[15] This contorts the plain language of Reg BI. Moreover, the report provides no evidence for its claim that disclosure at the point of sale matters the most. Indeed, research conducted by Greenwald Research has found evidence that waiting until the point of sale for disclosure is sub-optimal.
- The Phase II report states: "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."[16] This statement is not supported by the findings of the research. In addition to the comment above on point-of-sale disclosure, Reg BI does not require transaction-specific compensation disclosure. Indeed, the SEC and DOL both considered including such a requirement in Reg BI and the Fiduciary Rule, respectively, and rejected it.
- Reg. BI requires financial professionals to consider the cost of an investment in connection with any recommendation, but it does not require that either the firm or the financial professional "affirmatively offer and discuss lower-cost products" with customers. Question 29 in the Phase II questionnaire went beyond the requirements of Reg BI and asked if it "was firm policy to affirmatively offer and discuss lower cost products when recommending the product[s] listed below."
- Question 35 in the Phase II questionnaire asked, "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." Again, this question asked about behavior not required by Reg BI.
- Question 40 in the Phase I questionnaire asked, "In relation to the availability of lower-cost, suitable options outside the firm's platform, please indicate whether it was firm policy or

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[13] See, for example, Phase I questions 39 and 40 and Phase II questions 26-28 (questions 26 and 28 stated "at the time a recommendation was made").
[14] Phase I questions 28, 33-35.
[15] Phase II report, page 13.
[16] Phase II report, page 3.

practice to affirmatively discuss costs with customers at the time of the recommendation to buy, hold or sell a security." Reg BI does not require the firm or the financial professional to consider or discuss investment products not offered by the firm. In doing so, a financial professional may risk violating his or her firm's policies and FINRA rules. This question is irrelevant to determining compliance with Reg BI.

- Question 48 in the Phase II questionnaire asked if firms "Permit conferences or training program attendance where expenses are covered or reimbursed directly or indirectly and in whole or in part, by a product manufacturer, trade association or an insurance marketing organization." Reimbursement of expenses for attendance at training programs is specifically allowed under FINRA rules and, subject to appropriate controls and disclosures, not at odds with either the letter or the spirit of Reg BI. Perhaps more importantly, attendance at such events is often designed to educate financial professionals about investment products that their clients may find valuable. The report appears to suggest that attending educational meetings is not in the best interest of investors, without any consideration of either the existing regulatory regime or benefits to investors. Greenwald Research has found that many financial professionals believe these meetings are beneficial in helping to educate them about investment products so that they can better serve their customers.

The fact that the Phase I and II surveys expended so much effort to measure policies not required by Reg BI and did not measure policies required by Reg BI suggests that a main objective was not to measure compliance with Reg BI, but rather to seek further regulatory changes to Reg BI.

3. <u>Many of the questions demonstrate a lack of objectivity.</u>

The reports include multiple instances that demonstrate a lack of objectivity or unstated agendas on the part of the authors. For example, the Phase II report states that the information gathered from the surveys 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."[17] Establishment of a fiduciary standard of conduct for broker-dealers may be a goal of the Committee or the survey authors, but the SEC considered and specifically rejected the idea when it adopted Reg BI.[18] The surveys appear to have been designed less to establish whether Reg BI is establishing goals set by the SEC and more toward making policy arguments in favor of a different standard favored by the Committee.

A review of the questionnaires and reports also makes clear that the surveys were, in part, focused on reviewing firm practices about certain investment product types apparently disfavored and deemed by the survey authors to be "complex, costly, and risky" ("CCR"). The reports do not define any of these characteristics in either absolute or relative terms and seem to have created the CCR terminology as a "scarlet letter" without explaining why it is either accurate or relevant. It is important to note that Reg BI, as a conduct-focused standard, takes a product-agnostic approach to the obligations of financial professionals in making investment recommendations to customers. The Phase

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[17] Phase II report, page 1.

[18] See Exchange Act Release No. 34-86031 (the "Adopting Release") at 18.

I and II reports do not articulate why an extensive focus on these four products is relevant to actions taken by broker-dealers in response to Reg BI. The report states:

> "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.[19]" (Emphasis added.)

The reports do not contain any explanation of how the terms "complex," "costly," or "risky" are defined, or why any of these terms applies to the investment types listed. Even if any of them has one or more of these attributes, to simply state that all four investment types are complex, costly, and risky requires a logical leap that is clearly not warranted based on the findings of the surveys or any other information that has been provided.

A. The Committee Has Invented "CCR" Without Explanation

Other than in the reports, we are not aware of any regulatory or other agency that has used or referred to this classification of "CCR" investment products. While other regulatory agencies, including the SEC and FINRA, have referred to complex products over the years,[20] they have never referred to any of them as having all three traits or indicated that any of them are not appropriate for certain investors. This category appears to have been invented by the Committee for its own purposes, none of which have anything to do with Reg BI.

The terms "complex," "costly," and "risky" are all, by definition, relative. Even holding cash can be a highly risky investment. An investor who invested entirely in cash 10 years ago would have missed the 343% cumulative total return in the S&P 500 Index. It is simply meaningless to assert that that any product is "complex," "costly," or "risky" without providing the context for that designation and without comparing the product to other products with similar risk and reward characteristics. By creating this classification in the survey analysis, without clearly defining it or rooting it in any established regulatory practice, the Committee suggests a lack of objectivity that should be considered when reviewing the reports.

B. The Surveys and Reports Unduly Emphasize Four Products

As an indication of the Committee's focus on "CCR" products, we note that, aside from the first 13 questions in the Phase I questionnaire (which focused only on background information on the responding firms), 30% of the remaining questions pertained to the four "CCR" investment products. In the Phase II questionnaire (not including background questions), 29% of the questions were focused on the same four products.

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[19] Phase II report, page 6.

[20] See, for example, FINRA Regulatory Notices 12-03 and 17-32, and SEC Joint Statement Regarding Complex Financial Products and Retail Investors, October 28, 2020, available at https://www.sec.gov/news/public-statement/clayton-blass-hinman-redfearn-complex-financial-products-2020-10-28.

The reports appear to conclude that these four products are "complex, costly, and risky" at least, in part, by misreading FINRA's arbitration statistics. The reports provide no explanation of the characteristics that would make these securities, or any security, "complex, costly, and risky." Indeed, Greenwald's research with economists, financial professionals, and academics focused on financial planning and products concludes that investing a significant part of an investment portfolio in a mutual fund that invests in securities of foreign entities, utilizes futures or options contracts, or employs leverage, may be far riskier than any of the four investment types identified in the report.

The result is questionnaires unduly and prejudicially focused on a small subset of products at the expense of better understanding the full marketplace for financial advice and products. This confusing focus is one more indication of the authors' lack of objectivity.

C. The Reports Misinterpret FINRA Arbitration Statistics

The reports appear to have based their viewpoint that an investment product is "complex, costly, and risky" to a significant extent on FINRA's summary of arbitration claims. However, the number of arbitration claims involving a specific type of investment often says little about the investment itself, for at least four reasons:

i. The reports' reliance on arbitration claims is problematic for at least two reasons. An arbitration claim itself does not equate to the grant of a customer award. Moreover, many arbitration claims involve multiple investment products. An arbitration in which a registered representative is alleged to have inappropriately recommended many investments implies much more about the registered representative's practices or the firm's supervision than about the products that were sold. Moreover, the claims concerning the products that the reports deem "complex, costly, and risky" might have been concentrated among a small number of firms. The reports fail to differentiate those claims that are more relevant to the registered representative's own misconduct or a firm's supervision than to the investment underlying the claim.

ii. The reports failed to consider what the customers in these arbitrations claimed. According to FINRA, in 1,823 cases in 2020, customers alleged breach of contract, violation of blue-sky laws, "errors-charges," or error execution. Other allegations might have been made in some cases, but these charges do not imply that the product at issue was "complex, costly, or risky." The reports appear to assume that *any* alleged violation, in any customer claim, is tantamount to the product being "complex, costly, or risky." This assumption is obviously misplaced. In 2020, FINRA stated there were 385 arbitration cases pertaining to common stocks, 177 involving mutual funds, and 56 regarding government securities.[21] These cases do not imply that these investments are "complex, costly, or risky" or that they are somehow problematic for investors.

iii. The report refers to FINRA data on customer complaints giving rise to FINRA arbitration cases and state enforcement actions without any support.[22] There is no information on

[21] www.finra.org/arbitration-mediation/dispute-resolution-statistics/2020#top15securitycustomers.

[22] Phase II report, page 6.

state enforcement actions such as dates, recidivist actors, relevant states, or whether the actions were due to the product, firm, or representative actions or outright fraud.

The extensive focus on the four "CCR" investment products in the context of an examination of Reg BI—which is product agnostic—indicates that the authors of the surveys were motivated, at least in part, by a desire to discredit certain investment products more than trying to make an accurate measurement of compliance with Reg BI. Many other questions could have been asked to accurately measure firm compliance with Reg BI, but the focus on the four specific products "crowded out" the other avenues of inquiry. The preceding points lead to the conclusion that the Committee was not focused on an objective assessment of Reg BI compliance and strongly suggest the existence of a different, unstated agenda.

4. The surveys failed to collect information on key actions firms have taken that are pertinent to Reg BI and the best interests of their clients.

Areas that the surveys did not cover include the following:

- The extent to which firms have changed their criteria for selecting investment products that they offer to customers.
- The extent to which firms require financial professionals to document consideration of "reasonably available alternatives" in making investment recommendations to customers.
- The extent to which firms have modified compensation practices, particularly with respect to payout grids and other methods for determining compensation payable to financial professionals.
- The extent to which firms have implemented comprehensive training regimes and improved supervisory oversight for sales-related activities by financial professionals.
    - Training has been recognized by the SEC as a critical component in meeting the requirements of Reg BI.[23]
    - Research conducted by Greenwald Research has indicated that broker-dealers and dually-registered firms spent millions of dollars buttressing their training and supervision programs in response to the DOL Fiduciary Rule and continued these investments with the enactment of Reg BI.
- The extent to which firms have made comprehensive efforts to identify, disclose, and mitigate conflicts of interest that arise out of compensation practices.

[23] Rina Hussain, SEC Assistant Director of Broker-Dealer and Exchange Examination Program (BDX), Office of Compliance Inspections and Examinations (OCIE) stated in an October 26, 2020 SEC Roundtable Discussion on Reg BI that "[t]raining is critically important with the new rule." John Polise, SEC Associate Director of BDX and OCIE, said at the same Roundtable Discussion, training is "very important for Reg BI compliance." SEC Roundtable on Regulation Best Interest and Form CRS, October 26, 2020, available at https://www.sec.gov/video/webcast-archive-player.shtml?document_id=102620-best-interest-roundtable.

By failing to collect information on major actions pertinent to the effectiveness of Reg BI, the surveys fail to provide a comprehensive understanding of how companies are meeting the requirements and objectives of Reg BI and taking steps to serve the best interests of their clients.

5. The Committee's reports and other statements about the research contain several mischaracterizations of survey results.

The reports severely misinterpreted the data collected from the questionnaires, even assuming that the results presented are accurate. For example, the Phase II report states: "The overwhelming majority of Reg BI firms stated they did not cease sales of any products (93%) or restrict product sales (76%) as a result of Reg BI."[24] As previously stated, Reg BI is "product-agnostic" and does not restrict or prohibit any investment products. It is difficult to understand the connection between Reg BI and restriction on sales of investment products suggested in the reports. Also, as noted above, the surveys did not approach the issue of the impact of Reg BI effectively.

II. Major Deficiencies in Questionnaire Language

In designing the questionnaires, the authors failed to follow survey research industry standards, leading to an inability to accurately measure the relevant activities of respondents. There are several specific examples of this:

1. A number of terms used in the questionnaires are vague and hard to understand.

It is a common survey practice to give respondents clear definitions of terms, but the questionnaires often did not provide this. The use of vague or unclear terms forces respondents to interpret their meaning and leads to different interpretations, responses, and unreliable answers, thus undercutting the value of the survey responses. Examples of vague terms include:

- "place customers in any of the following product types,"[25]
- "formal limitations,"[26]
- "has ever engaged in,"[27] and
- "practice."[28]

For example, a company "practice" can be defined in a variety of ways, including a "usual activity," an "expected activity," an "activity conducted most of the time," or "all of the time." All the respondents our firm interviewed indicated they were uncertain of the meaning of "practice" as they filled out the questionnaires. The vagueness of the word "practice" is especially salient because one of the stated objectives of the surveys was to measure the activities of the companies that received the questionnaires.

[24] Phase II report, page 4.
[25] Phase I, question 19.
[26] Phase I, question 25.
[27] Phase I, questions 44-59.
[28] E.g., Phase I, question 35 and Phase II, questions 33, 35, 27, 39, 41 and 43.

Appendix II of this report lists numerous examples of questions with vague and unclear terms.

2. Answer categories did not allow many respondents to record accurate answers.

A notable and frequent example of this in the Phase I and II questionnaires were questions that limited responses to "yes" or "no" (or in some cases only a third alternative of "N/A")[29] when the correct answer to the question would have required other choices and/or additional detail. It is best practice in survey design to allow for both complete and accurate responses, or if that is not feasible, to offer a response of "other" or to allow a comment or explanation. All the respondents we interviewed indicated that there were a number of questions that only offered "yes" and "no" responses in situations in which neither of those responses accurately reflected their answer to the question. Questionnaires distributed to member firms by other regulatory entities often allow respondents to add information on an open-ended basis to provide context and additional detail that can enhance understanding of the issue.

While some of the states that sent the surveys did informally allow respondents to offer additional explanation in a separate document (outside of the survey tool), the instructions in the surveys did not mention this as an option, and some of the respondents interviewed stated that they were not aware that additional explanations could be submitted. In addition, there is no evidence in any of the reports or public statements that the Committee reviewed the supplemental responses, "corrected" survey data based on the supplemental submissions, or integrated these supplemental explanations into the analysis or reports.

Appendix II of this report lists numerous examples of questions with inadequate answer categories.

III. Major Deficiencies in the Survey Process

Best practices in administering an online survey include: 1) sufficient reporting on sampling procedures to allow those who study the research to evaluate the extent to which the respondents reflect the population the researchers are purporting to measure, 2) use of an adequate questionnaire program that allows respondents to fill out the questionnaire accurately, and 3) taking adequate precautions to ensure that respondents took enough time to fill out the questionnaire accurately. Unfortunately, the surveys did not meet any of these best practices.

[29] In the Phase I questionnaire, the following questions had three answer categories: "Yes," "No," or "N/A,": 14, 16, 44-59. The following questions in the Phase I questionnaire had two answer categories: "Yes," or "No:" 10, 13, 15-17, 61-69. In the Phase II questionnaire, the following questions had three answer categories: "Yes," "No," or "N/A": 58, 59, 61-63. The following questions in the Phase II questionnaire had two answer categories: "Yes," or "No:" 7, 8, 34, 36, 38, 40, 42, 44, 45-57, 64-71.

1. There is insufficient information on sampling procedures to evaluate their accuracy.

To evaluate sampling, a reader of the reports must be able to determine how respondents were selected from the overall population. The Phase I report indicated that the participating states sent the Phase I questionnaire to over 2,000 firms, with approximately 75% of those firms being broker-dealers. Questionnaires were issued to firms identifying their primary offices in 34 states. However, no information was given on how the firms were selected and if the states that chose firms to be questioned used the same selection procedures. The only information provided, other than sample size by broker-dealer or investment adviser, was that the 50 largest broker-dealer firms were instructed to participate in the survey.[30] This is a deviation from random selection and unless other adjustments are made, renders the sample unrepresentative. (Of course, it may also be unrepresentative in other ways, but insufficient information was provided on this issue.).

The report also indicates that 443 "FINRA" firms participated in the Phase II survey, including 382 firms which participated in the Phase I survey. However, no information was provided on how those firms were selected, nor how they compared to the firms which participated in Phase I. The 382 firms which participated in both surveys are described as a "control sub-group,"[31] but the extent to which they reflect the sample of "FINRA" firms from Phase I, or what makes those firms characteristic of a "control sub-group" cannot be determined. It is also unclear why the Phase II survey did not include any of the investment adviser firms surveyed in Phase I.

2. There is no evidence that the Committee used proper weighting procedures in reaching key conclusions.

The Chairwoman of the Committee has stated that the results of this research can be used to "shed light on what American workers experienced in the marketplace for investment advice as recently as 2018."[32] In order to assess the impact of firm actions on American workers, recognition must be given to the fact that some firms serve many more retail clients than others. Thus, giving very small firms the same weight as large firms results in data that does not accurately reflect the way the marketplace is being served. There is an accepted method for dealing with this: weighting the responses of firms by the number of each firm's clients. While data on the number of retail clients was obtained, it appears that the data were not weighted.

3. The version of the Survey Monkey program used to collect the responses is not up to current industry standards.

The version of Survey Monkey used did not allow open-ended comments to be entered by respondents and required that every question be answered with one of the choices listed in the questionnaires. Providing open-ended responses and additional comments is a crucial part of accurate survey research and there are many software programs available with this capacity. The surveys did not employ any of these tested research programs which are more appropriate for the scope of the

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[30] Phase I report, page 2, footnote 3.

[31] Phase II report, page 2.

[32] Written Testimony of Andrea Seidt, "Improving Investment Advice for Workers and Retirees," United States Department of Labor, Employee Benefits Security Administration, September 3, 2020.

survey the Committee attempted. Moreover, as stated above, there is no evidence that the Committee reviewed the supplemental responses that were submitted separately or integrated them into their analysis and reports.

4. The implementers of the surveys did not take steps to ensure that respondents took an adequate amount of time to properly fill out the questionnaire.

A widespread problem in online surveys is that a number of respondents fill out questionnaires too quickly, with little regard to accuracy. If respondents do not take a reasonable amount of time to provide responses, the accuracy of responses will be reduced. The common term for these respondents is "speeders." Research analysts have developed techniques for identifying speeders and deciding whether or not their responses should be included in the analysis. It appears that the implementers of the Phase I and II surveys did not take these precautions.

The instructions accompanying the questionnaires estimated a completion time of one hour, while all the firms we interviewed reported the time to complete as significantly longer than that.[33] When the questionnaires were first distributed, several industry trade associations raised the issue of the length of time necessary to respond accurately. In response, the Committee reported "Over a thousand firms have successfully navigated the survey with an average entry time of thirty minutes."[34] Even a cursory look at the number of questions and depth of the matters covered in the surveys leads to the conclusion that most, if not all, firms would need more than 30 minutes to fill out the questionnaire accurately. Given their own estimate of the duration needed to respond to the questions and the industry organizations' assessments, the Committee had a due diligence obligation to take steps to ensure the firms who filled out the form in a very short period of time took the proper amount of care to ensure that their responses were accurate. These steps were not taken.

CONCLUSION

As addressed above, the Committee did not follow clear and well-established survey research standards. The result is research findings and conclusions that cannot be relied upon as accurate measures of firm behavior nor compliance with Reg BI, the impact of the regulation, or the extent to which investors are well served. Any attempt to realistically assess the impact of Reg BI and achieve NASAA's stated research purpose would require a completely new survey or other type of analysis.

[33] For example, in a number of cases it took between 20 to 40 hours.

[34] "NASAA REGULATION BEST INTEREST NATIONAL EXAM INITIATIVE 2020," Answer 10 (NASAA), available at https://38vz.short.gy/n43mhP.

APPENDIX I

- Dr. Greenwald was appointed by the U.S. Congress to be a Delegate to both the 1998 and 2002 National Summits on Retirement Saving.
- He was asked two times to testify before the U.S. Senate Committee on Aging on topics related to the financial security of retirees.
- He was elected to the Market Research Council, a group of the nation’s leading market researchers.
- His firm was appointed by the Social Security Administration to be part of a consortium on financial literacy. Other members of the consortium were Dartmouth College, Harvard University, the University of Pennsylvania, and RAND. Dr. Greenwald was the project director for that work.
- Dr. Greenwald has authored numerous articles and has frequently been asked to make presentations on investment-related topics.

APPENDIX II

This Appendix provides a more detailed listing of key questions or statements which did not meet commonly accepted survey research standards.

Vague and unclear terms:

- Several terms were unclear in the Phase I questionnaire, as confirmed by the interviews conducted with respondents.
    - Questions 18, 19-27 and 29-36 asked about: "private securities." It was not clear what was included in this category.
    - Questions 22-25 asked about "formal limitations" placed on the sale of four investment products based on various criteria. Respondents were unclear on the meaning of the term "formal limitations" and most answered only if they had written policies. Moreover, no questions were directed to supervision or oversight policies.
    - Question 24 asked about limitations based on "customer's liquidity needs (e.g., concentration limit)." This conflates the meaning of the terms "liquidity needs" and "concentration limit." They are not synonymous and led to confusion among respondents.
    - Question 38 includes the term "fees charged for various 'asset classes'." Several firms were not sure what is meant by asset classes.
    - Questions 42 and 43 include the term "educate customers." Many respondents were unclear on what activities amounted to education.
    - Questions 44 through 59 asked about whether the firm "has ever engaged" in various compensation practices. Firms interpreted the term "ever" in different ways. Some believed it meant a recent time period, but one that was not defined or explained. Others believe it covered the entire time the firm has existed, which was, in many cases, impossible to ascertain. Overall, there was not a common definition of the period, meaning the responses should not be compiled or analyzed because different respondents interpreted the meaning of the questions in different ways.
- Several terms were unclear in the Phase II questionnaire, as confirmed by the interviews conducted with respondents.
    - Question 21 includes the term "sales contest." The meaning of that term was unclear for some respondents.
    - Question 25 asked about "deferred management or service fees." Those terms were unclear to some respondents.
    - The preface to question 33 asked whether different actions were an "expected practice (not formalized in a procedure manual)." Some respondents were not sure what was intended by "expected practice." Since the questionnaire writers did not

clearly differentiate between a formal policy and an expected practice, it made it even harder to interpret the two terms.

  - Question 37 asked, “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.” Many of the firms we interviewed understood the term “lower-cost suitable options offered outside the firm” to mean <u>all</u> options offered by <u>all</u> firms that meet the definition of lower-cost and suitable. Because it is not possible to vet all outside options it is not possible for firms/representatives to discuss them with customers. Moreover, firm/representatives are not allowed to offer options provided outside the firm. At best, it is unclear what the question writers were referring to.
  - Question 55 asked if a firm will “Neutralize cost to customer where differential compensation is utilized.” It was not clear to respondents what “neutralize cost” meant.

<u>The questionnaire is ineffective and unclear in asking about the impact of Reg BI</u>. Questions 34, 36, 38, 40, 42 and 44 of the Phase II questionnaire asked, “Please indicate whether the requirement was adopted as the result of the Regulation Best Interest.” As discussed in the analysis above, the adoption of Reg BI may have been a factor in the adoption of a policy, but not the exclusive cause; or a given policy may relate to Reg BI but have been put in place prior to its adoption. It is difficult, if not impossible, to determine what is meant by this phrase.

<u>The surveys did not measure key company “practices” effectively and therefore did not get information on some of the most important and effective activities that protect investors’ best interest</u>.

- Question 34 in the Phase I questionnaire used the word “practice.” In the Phase II questionnaire questions 33, 35, 37 and 39 used the terms “policy or practice.” A number of firms interviewed were unsure of what was meant by “practice.” For example, some of the respondents interviewed do not consider training a practice and did not refer to training when asked about practices. Additionally, some respondents thought practice only referred to actions that were put in writing, while others thought a practice was not confined to actions put in writing but also inclusive of typical activities or behavior.
- While the Merriam-Webster dictionary defines “practice” as “the customary, habitual or expected procedure or way of doing something,” written policies and procedures have a specific and accepted meaning for broker-dealers. The term “practice” has no such accepted meaning and led to difficulties in answering these questions.
- By not carefully defining what a “practice” is, the surveys did not adequately obtain information about behaviors, supervision, training, and other common and usual activities that help ensure that investors’ best interests are met.

<u>Many answer categories were too limiting and did not allow respondents to record an answer that accurately reflected their response to the question</u>.

- In the Phase I questionnaire questions 14 and 44-59 had three answer categories: “Yes,” “No,” and “N/A,” meaning not applicable. Questions 10, 13-17, and 61-69 had only two answer categories: “Yes” and “No”.
- In the Phase II questionnaire questions 58, 59, 61-63 had three answer categories: “Yes,” “No,” and “N/A,” meaning not applicable. Questions 7, 8, 34, 36, 38, 40, 42, 44, 45-57, 64-71 had two answer categories: “Yes” and “No”.

It is a survey industry standard practice to provide an “other” category in cases in which complexity or other factors render “yes” and “no” responses inadequate to provide an accurate response. In many cases, the respondent is given an opportunity to specify the reason for an “other” response. In this case, this option was not provided.