



March 23, 2023

Via Electronic Mail (rule-comments@sec.gov)

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. S7-32 -22: Best Execution Rule

Dear Ms. Countryman:

The Private Investor Coalition (“PIC”) submits this letter in response to the U.S. Securities and Exchange Commission’s (“SEC” or “Commission”) recent rule filing regarding proposed Regulation Best Execution (“Proposal” or “Proposed Reg Best Ex”).¹ PIC appreciates the opportunity to comment on the SEC’s Proposal.

PIC is a nationwide organization consisting of single family offices (“SFOs”) who share a common interest in public policy issues impacting the SFO community. As discussed below, we are concerned that including SFOs in the definition of “retail customer” will negatively affect SFOs by further increasing their transaction costs and causing broker-dealers that service institutional customers to reduce or eliminate the services and products they provide to SFOs. Therefore, the definition of “retail customer” should be revised to exclude family offices, as the SEC suggests in the Proposal. In addition, we also question the overall utility of the Proposal since most of the issues covered by the Proposal are already adequately covered by existing requirements. We discuss our views more fully below.

I. The SEC Should Revise the Definition of “Retail Customer” To Exclude SFOs; Not Doing So Will Harm These Investors, Who Are More Properly Classified As Institutional Customers.

Proposed Reg Best Ex would expressly require “more robust” policies and procedures for “conflicted transactions” on behalf of “retail customers.” Specifically, if a transaction with a retail customer meets the SEC’s definition of “conflicted transaction,” Proposed Rule 1101(b) would require broker-dealers to have additional policies and procedures and documentation that address how they will assess information beyond what is required for non-conflicted transactions. A

¹ Regulation Best Execution, 88 Fed. Reg. 5440 (Jan. 27, 2023) (“Proposal”), available at <https://www.govinfo.gov/content/pkg/FR-2023-01-27/pdf/2022-27644.pdf>.

“conflicted transaction” would be defined as any “transaction for or with a retail customer” where a broker dealer: (1) executes an order as principal or riskless principal; (2) routes an order to, or receives an order from, an affiliate for execution; or (3) provides or receives payment for order flow as defined under Rule 10b-10(d)(8) under the Exchange Act. A “retail customer,” in turn, is defined as “the account of a natural person or held in legal form on behalf of a natural person or group of related family members.”² The definition of “retail customer” would capture SFOs and many of the investment vehicles they manage on behalf of the families they serve.

A. If the SEC Excludes a Subset of Family Offices from the Definition of “Retail Customer,” This Subset Should Align to the Definition of “Institutional Family Office” in the SEC’s Regulation Best Interest No-Action Letter.

In the Proposal, the SEC asks whether the definition of “retail customer” should exclude a “family office,” as defined in Rule 202(a)(11)(G)-1(b) under the Investment Advisers Act of 1940.³ The SEC also asks whether, alternatively, the definition should exclude a subset of family offices. PIC believes that “family offices” should either be excluded from the definition of “retail customer” or, at a minimum, that “family offices” are granted the ability to opt out of being treated as a “retail customer” under the rule. We recommend that the Commission adopt the same approach for family offices under the Proposal that the Commission adopted in the SEC’s Regulation Best Interest No-Action Letter (“Reg BI No-Action Letter”). Namely, the Reg BI No-Action Letter established a category of family offices, “Institutional Family Office” (“IFO”), where the IFO could elect not to be treated as a retail customer for purposes of Reg BI.⁴ The definition of IFO in that no-action letter is a family office that: (A) has retained one or more experienced securities or financial services professionals; (B) has assets under management that are institutional in size (specifically, \$50 million or more); and (C) is not relying on the broker-dealer for any recommendations and is acting independently of the broker-dealer. Entities that qualify as IFOs are more properly classified as “institutional investors”; they are not “retail customers.”

We note that the SEC includes in the Proposal an example of a type of family office that might be excluded from the definition of “retail customer.” This example does not align perfectly with the definition of IFO because it includes as a required element that the family office employ

² Proposed Rule 1101(b)(4).

³ Proposal, at 5466.

⁴ See No-Action Letter from Emily Westerberg Russell (SEC) to Stephanie Nicolas (WilmerHale) (Dec. 23, 2020), available at <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/sifma-122320-regbi.pdf> (“Reg BI No-Action Letter”).

professionals who are independent representatives of the family clients.⁵ If the SEC decides to exclude only a subset of family offices from the definition of “retail customer,” we urge the SEC to adopt the same definition of IFO that it is in its Reg BI No-Action Letter. Conformity of terms, definitions and effect will ensure maximum compliance and utility. Not doing so would cause confusion and be disruptive to the marketplace. Broker-dealers and family offices are already familiar with the IFO definition and have adopted policies and procedures to comply with it. Moreover, the SEC Staff have already determined that this definition is properly calibrated to exclude entities that operate as institutional investors from the definition of “retail customer” for purposes of Reg BI. Accordingly, to the extent the SEC decides it is appropriate to exclude only a subset of SFOs from the definition of “retail customer,” it should align this subset with the definition of IFO.

B. Why It Is Necessary To Exclude SFOs From the Definition of “Retail Customer.”

We are concerned that SFOs would be significantly disadvantaged if they are not excluded from the definition of “retail customer.” As noted above, Proposed Reg Best Ex will impose additional obligations on broker-dealers that engage in “conflicted transactions” with “retail customers.” Because most SFOs operate more like institutional investors than “retail customers,” many of the broker-dealers that provide services to SFOs do not have retail customers and, instead, provide services to an institutional customer base. These broker-dealers often provide liquidity for large-size orders and trade on a riskless principal or principal basis. Accordingly, they regularly engage in what the SEC would view as “conflicted transactions.” If SFOs are considered “retail customers” under an enhanced best execution obligation, these broker-dealers may withdraw their services to SFOs in order to avoid being subject to the more burdensome regulatory regime for “conflicted transactions.” This is a reality that the SEC acknowledges in the Proposal, when it notes that certain broker-dealers may withdraw or alter their services in order to avoid triggering the more onerous “conflicted transaction” requirements.⁶ Such an outcome would have severe negative consequences for SFOs and, in fact, is what occurred upon implementation of Reg BI. It would disrupt the products and services SFOs receive from broker-dealers today and, consequently, also impede the flow of capital into the marketplace.

⁵ The Proposal provides the following example of family offices that may be excluded from the definition of “retail customer”: family offices that (1) have one or more experienced securities or financial services professionals, (2) manage a threshold level of total assets (e.g., \$50 million or more) that are indicative of an institutional account, (3) have the capacity to evaluate independently the execution quality received from the broker-dealer, and (4) *have professionals who are independent representatives of their family clients*. Proposal, at 5466 (emphasis added). With regard to the fourth element, while non-family member status is a consideration in the Reg BI No-Action Letter for whether the family office has “employed one or more experienced securities or financial services professionals,” it is one of many elements that a broker-dealer must consider but not a dispositive element. Nor should it be because a professional manager who happens to be a family member may be just as, if not more, sophisticated and experienced as a non-family member. Further, it is not clear what the purpose of being “independent” is or what “independent” means here when a “family office” must be owned and controlled by the family it serves.

⁶ “The Commission preliminarily believes that each broker-dealer that would be required under the proposed rules to comply with provisions of the proposal applicable to conflicted broker-dealers would consider its options under the proposed rules strategically. For some firms, the costs of staffing the activities required for compliance would exceed their expected profits from conflicted transactions.” Proposal, at 5530.

To avoid this harmful outcome for SFOd, PIC urges the SEC to exclude SFOs from the definition of “retail customer,” as the SEC suggests in the Proposal but conformed to the treatment afforded under Regulation Best Interest. The reasons for excluding SFOs from the definition of “retail customer” in the context of Regulation Best Interest apply equally here.⁷ In particular, SFOs that meet the definition of IFO should be excluded because:

- They have traditionally been treated by broker-dealers as institutional clients given their sophistication and significant assets under management. To this end, SFOs are engaged in the securities industry on a daily basis utilizing professionals that have extensive experience in the space. They are legal entities established by wealthy families to manage their investments and provide other services, such as tax and estate planning.
- SFOs also operate as institutional, and not retail customers, in terms of their trading needs and the services they receive from broker-dealers. Specifically, staffed with their own financial professionals and often their own trading desks, SFOs do not need or receive the types of services that typical retail customers receive. Instead, SFOs most often receive the institutional services that broker-dealers provide to their institutional investors. These differences in services reflect, in part, the significant amount of assets managed by family offices (e.g., \$50 million or more) and the nature of their investments and trades, which also may be significant in size. For example, given their trading and investment needs, they may (i) be prime brokerage customers, (ii) have access to broker-dealers’ institutional-side order management systems that allow direct market access to exchanges and broker-dealer algorithms, and (iii) clear and settle their trades directly with broker-dealers and custodian firms through DTCC’s institutional trade processing services. Unlike retail customers, SFOs are often customers of broker-dealers’ institutional sales and trading desks, have direct access to institutional traders and market makers, and receive market and trader commentary regarding products such as swaps, volatility trades, and exotic options that are not generally available to retail customers.
- Like many institutional investors, SFOs may have large or concentrated positions that they may seek to hedge through customized OTC derivatives or other hedges. Broker-dealers may offer tailored solutions to them and other institutional investors for these hedging needs. SFOs also may want to participate in less conventional investment opportunities that are not available to retail investors, such as private equity investments, other private offerings and structured products. These investment and trading opportunities generally are not available to “retail customers” because there is a concern that they may not be able to fully understand and independently evaluate the risks they entail.

In sum, without an exclusion from the definition of “retail customer,” broker-dealers will likely reduce or eliminate the critical products and services they provide to SFOs today. Many of

⁷ See SEC No-Action Letter to Stephanie Nicolas (WilmerHale), dated December 23, 2020, submitted on behalf of the Securities Industry and Financial Markets Association (“SIFMA”).

the products and services provided by broker-dealers to SFOs are only available to institutional customers and would no longer be available to SFOs if they are considered “retail customers” under the Proposal. Accordingly, PIC strongly encourages the SEC to exclude “family offices” from the definition of “retail customer” under the Proposal or, at a minimum, exclude IFOs from this definition.

II. Proposed Reg Best Ex Will Unnecessarily Increase Costs to Broker-Dealers, Which In Turn Could Increase Costs to Investors.

Proposed Reg Best Ex would create a federal best execution standard for broker-dealers and require them to establish, maintain and enforce written policies and procedures reasonably designed to comply with that standard. However, broker-dealers are already subject to a best execution obligation under federal securities laws and self-regulatory organization (“SRO”) rules, as the SEC states in the Proposal.⁸ Accordingly, it is not clear why a federal best execution rule is necessary or how the need for such a rule will outweigh its costs to investors. To this end, FINRA established the very same best execution standard years ago, and over the years has provided guidance on how broker-dealers should assess their compliance with the best execution obligation as the markets and technology continually evolve.⁹ The SEC reviewed and approved FINRA’s rule in 2011.¹⁰ FINRA also conducts regular examinations to assess broker-dealers’ best execution policies and procedures, and it sanctions broker-dealers when it determines their policies and procedures are not sufficient or when firms’ reviews of trade executions are not reasonable. The exams are funded by fees paid by broker-dealers and, by extension, investors.¹¹

If the Commission has concerns with the SROs’ current best execution standards, we believe it would be more efficient to address these concerns with the SROs, as the SEC has done with other SROs that have failed to enforce their rules.¹² It also would be more cost-effective for both investors and broker-dealers. The SEC estimates that, as a result of Proposed Reg Best Ex, broker-dealers will incur aggregate one-time compliance costs of \$165.4 million and \$128.9 million in annual costs as they update or create policies and procedures for the handling, execution, and review of customer orders.¹³ Apart from these direct costs, there will be indirect costs. The SEC acknowledges that some of these direct and indirect costs could be passed through to customers in the form of higher commissions or reduced services.¹⁴

In addition to the negative consequences of increased costs and reduced services for investors, we are concerned that certain prescriptive language in Proposed Reg Best Ex does not

⁸ Proposal, at 5482.

⁹ *See, e.g.*, FINRA Regulatory Notices 15-46 and 21-23.

¹⁰ Exchange Act Release No. 65895 (Dec. 5, 2011); Proposal, at n.3. The MSRB also has a best execution rule for municipal securities, Rule G-18, which the SEC also reviewed and approved.

¹¹ Broker-dealers and their customers paid \$660 million to FINRA in 2021, in the form of various regulatory revenues such as assessments on gross income, assessments on personnel, assessments on branch offices, and fees for trading activity. <https://www.finra.org/sites/default/files/2022-06/2021-FINRA-Financial-Annual-Report.pdf>.

¹² <https://www.sec.gov/litigation/admin/2013/34-69726.pdf>.

¹³ Proposal, at 5529.

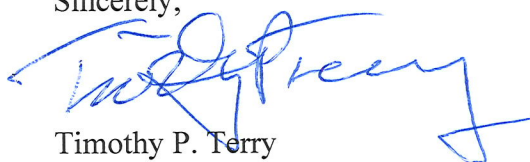
¹⁴ Proposal, at 5483.

give enough discretion to broker-dealers in handling customer orders and could result in worse executions for large-size orders, as are typically placed by SFOs. Historically, both the SEC and FINRA have recognized the importance of minimizing the potential for “leakage” and “slippage” in handling large-size orders.¹⁵ Proposed Reg Best Ex, however, seems to minimize the importance of these considerations and focuses primarily on identifying “material potential liquidity sources” that provide the best opportunity for price improvement or mid-point pricing.¹⁶ Certain statements in the Proposal could be read to suggest that broker-dealers should send orders to venues that provide mid-point pricing in order to satisfy their best execution obligation for NMS stocks. While this may be appropriate for some orders, it is not appropriate for all orders, in particular, larger-sized orders.¹⁷ For these reasons, while we understand the Commission’s desire to ensure best execution standards for investors, we believe that the Proposal may actually do more harm than good both in terms of cost and in achieving the desired result.

* * *

PIC would be pleased to answer any questions you may have regarding the requested relief. Thank you for your consideration of this matter.

Sincerely,



Timothy P. Ferry
Secretary

¹⁵ Proposal, at 5462 (“For example, when a broker-dealer is handling and executing large orders, it may likely be more sensitive to the possibility of information leakage and price impact that could harm the execution quality of such orders. Therefore, the broker-dealer may make a best market determination designed to minimize the risk of information leakage and price impact concerns.”).

¹⁶ Proposed Rule 1101(a)(ii) and (iii) (“Such policies and procedures shall address how the broker or dealer will comply with the best execution standard by ... (ii) [i]dentifying markets that may be reasonably likely to provide the most favorable prices for customer orders (“material potential liquidity sources”); and [i]ncorporating material potential liquidity sources into its order handling practices”).

¹⁷ In the Proposal, the SEC states for a broker-dealer in NMS stocks, its policies and procedures for the best market determination could include assessments of any “assurances from a wholesaler that certain orders routed by the retail broker-dealer to the wholesaler would be guaranteed midpoint executions by the wholesaler or otherwise exposed to opportunities for midpoint executions.” In the event the wholesaler cannot provide such assurances, the Commission notes that the policies and procedures may provide for an assessment as to whether customer orders would best be executed with midpoint liquidity that may be available on an exchange, ATS, or other market. Proposal, at 5460.