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June 06, 2019

SEC Adopts Package of Reforms Aimed at Raising the Standard of Conduct for Brokers and Clarifying an Investment Adviser's Fiduciary Duty

On June 5, 2019, the U.S. Securities and Exchange Commission ("SEC") adopted a [package of rules and interpretations](#) relating to the standards of conduct for broker-dealers and investment advisers, including a new "best interest" rule for broker-dealers. The package was adopted by a 3-1 vote, with Commissioner Robert J. Jackson Jr. as the [lone dissenter](#). Chairman Jay Clayton, who supported the package, [stated](#) that the SEC was not adopting a uniform fiduciary rule for broker-dealers and investment advisers. Instead, Chairman Clayton explained that "Regulation Best Interest incorporates fiduciary principles, but is appropriately tailored to the broker-dealer relationship model and will preserve retail investor access and choice." Chairman Clayton, as well as the SEC's press release, emphasized that Regulation Best Interest cannot be satisfied by disclosure alone, but rather through compliance with each of the rule's four substantive obligations. The actions taken on June 5 include the following:

Regulation Best Interest

[Adoption of a new rule](#) (Rule 15l-1 under the Securities Exchange Act of 1934) that imposes a new standard of conduct for broker-dealers that substantially enhances the existing "suitability" requirement. The "best interest" standard of conduct provides specific requirements to address certain aspects of the relationships between broker-dealers and their clients, including certain conflicts related to compensation. Regulation Best Interest establishes four key obligations for broker-dealers:

- *Disclosure* — disclose material facts regarding, among other things, fees and conflicts of interest;
- *Care* — exercise reasonable care and skill in making recommendations to clients;
- *Conflicts of Interest* — adopt and implement written policies and procedures reasonably designed to identify and eliminate or disclose conflicts of interest; and
- *Compliance* — adopt, implement and enforce policies and procedures reasonably designed to comply with Regulation Best Interest.

Form CRS

[Adoption of a new disclosure form](#) that broker-dealers and investment advisers will be required to deliver to retail clients. The form summarizes information about services, fees, costs, conflicts of interest, and disciplinary history of the firm and individuals.

Investment Adviser Interpretation

[Issuing a release](#) setting forth the SEC's interpretation of existing legal guidance regarding an investment adviser's fiduciary duties. The interpretive release is intended to reaffirm and clarify "certain aspects of the federal fiduciary duty that an investment adviser owes to its clients." Importantly, the duty applies to the entire relationship between an investment adviser and its client. The final interpretation, like the proposed version, focuses on clients' best interests and conflicts of interest.

"Solely Incidental" Interpretation

A broker-dealer who provides investment advice to its clients that is "solely incidental" to its business as a

broker or dealer and does so without receiving any "special compensation" for the advice is excluded from the definition of "investment adviser" and not subject to the Investment Advisers Act of 1940. [The release](#) issued by the SEC provides that advice is solely incidental if it "is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions."

Other Statements

Commissioners [Hester Peirce](#) and [Elad Roisman](#) also issued statements explaining their support for the package. Commissioner Peirce noted that with an effective date of June 30, 2020, broker-dealers will need to quickly adopt the substantive provisions of Regulation Best Interest requirements. In addition to Commissioner Jackson's dissenting statement and votes on each item, the Investor Advocate of the SEC, Rick Fleming, issued a [statement](#) criticizing the SEC's interpretive releases and Form CRS.

More to Come

We will provide a more thorough discussion and analysis of each of these rules and interpretations, please stay tuned.

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