Blogs
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Asset Management ADVocate

The SEC's Fiduciary Rule Proposal - Implications for Investment Advisers (Part 1)

On April 18, 2018, the SEC held an open meeting where it approved the long?awaited and much-discussed fiduciary rulemaking proposal package. The proposal primarily recommends disclosure- and principles and procedures-based rules, and has garnered three main criticisms: (1) it would establish a "best interest" standard without defining the term; (2) while intending to provide clarity, it would likely generate litigation around the scope of the restated investment adviser fiduciary duty; and (3) it fails to cover how a new "relationship summary" disclosure would function in the robo-adviser context. Part one of this series provides a high?level overview of the recent history behind the proposal and summarizes its key provisions. Forthcoming posts will discuss the proposal in greater detail and suggest key takeaways for investment advisers.

Background

The notion of a uniform fiduciary rule for investment advisers and broker-dealers has been debated since at least the late 1990s, when the SEC proposed a rule that would exempt fee-based broker-dealers from investment adviser registration. In 2010, the DOL released its first proposal to enhance fiduciary protections around retirement investment advice, and Section 913 of the Dodd-Frank authorized, but did not oblige, the SEC to adopt a standard of conduct for broker-dealers under the Exchange Act that, at a minimum, was at least as stringent the Advisers Act fiduciary standard. The following year, the DOL withdrew its proposal in response to fierce industry criticism, and SEC staff issued a report recommending that the SEC adopt a uniform fiduciary duty rule for advisers and broker-dealers. The SEC again turned significant attention to the topic after the DOL adopted its fiduciary duty rule in 2016 for advice to certain retirement accounts. The DOL's fiduciary rule has been opposed as unwieldy and costly and was delayed by the current presidential administration, prompting some states, for example New York, Massachusetts, New Jersey and Maryland, to step in with their own fiduciary standards for broker?dealers. The DOL fiduciary duty rule was recently vacated by the U.S. Court of Appeals for the Fifth Circuit; the DOL has generally stayed mum on further plans for the rule. SEC Chairman Jay Clayton included the adviser/broker-dealer standard of conduct in his regulatory flexibility agenda from the start. In June 2017, Clayton sought comments from the industry and retail investors, promising a constructive collaboration with the SEC. The resulting Proposal, which is open to further public comment for 90-days, weighs in at approximately 1,000 pages and over 1,800 footnotes.

In a Nutshell

The proposal has three key components: **Regulation Best Interest**. Under this proposed rule, broker-dealers making recommendations to retail investors would be required to act in and prioritize customers' "best interests." A safe harbor would be available to brokers-dealers that:

- disclose key facts, including material conflicts of interest;
- exercise the "reasonable diligence, care, skill, and prudence" necessary to form a belief that a recommended product is in the customer's "best interest;" and

- implement policies and procedures mitigating material conflicts of interest arising from financial incentives.

Investment Adviser Fiduciary Duties. The SEC's proposed interpretation of investment adviser fiduciary duties would reaffirm and clarify that investment advisers have fiduciary duties of care and loyalty requiring them to:

- provide advice that is in clients' "best interests;"
- seek the most favorable transaction costs under the circumstances ("best execution");
- provide advice and monitoring over the course of the client relationship; and
- put clients' interests first, while also not "unfairly" favoring one client over another.

Form CRS (Customer/Client Relationship Summary). Under this proposal, investment advisers, broker-dealers, and dual-registered investment adviser/broker dealers would need to deliver a standardized "Relationship Summary" on new Form CRS, which is a four?page disclosure document describing:

- the services offered by the adviser and/or broker-dealer firm;
- the legal standards of conduct applicable to the firm;
- the fees a customer might pay; and
- and certain conflicts of interest that may exist.

The SEC has provided examples of the Relationship Summary containing lists of "key questions" that a client should ask a firm in considering whether to form a relationship. With a goal of reducing investor confusion, the proposal would also limit the circumstances under which broker-dealers and their associated persons can use the terms "adviser" and "advisor" in their titles, and require broker-dealers and investment advisers to disclose to their retail customers the capacity in which they are acting.

More Posts to Come

Please come back for our subsequent posts on this topic, which will discuss:

- more on the SEC's discussion of advisers' fiduciary duties;
- newly-proposed licensing and education requirements of investment professionals, as well as financial and similar matters;
- newly-proposed Form CRS; and
- proposed amendments to Form ADV through a newly proposed Form CRS.

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