

CLIENT ALERT

SEC Proposes Enhancing Requirements Affecting How Brokers and Investment Advisers Deal With Retail Investors

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The Securities and Exchange Commission (“SEC”) and its staff, for many years, have been studying the questions of whether retail investors understand the significance of the differences between investment advisers and broker-dealers, and whether and how much to harmonize the regulation of investment advisers and broker-dealers. Among its other efforts, the SEC sponsored a study by the RAND Corporation, published in 2008, that concluded that many retail investors did not understand the key differences between investment advisers and broker-dealers.¹ The SEC staff further studied these issues as mandated by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, resulting in the staff’s recommending that the SEC engage in rulemaking to adopt a uniform fiduciary standard of conduct for broker-dealers and investment advisers.² The Department of Labor has focused on similar issues in connection with its efforts to adopt and implement rules (referenced as the “DOL Fiduciary Rule”) clarifying who is a fiduciary under the Employee Retirement Income Security Act of 1974 and the applicable standard of conduct.

¹ Angela A. Hung, et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

² *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) available at www.sec.gov/news/studies/2011/913studyfinal.pdf.

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On April 18, 2018, the SEC published three separate but related releases containing proposals intended to address these issues, including several proposed new rules and disclosures and a proposed interpretation. According to the SEC, if these proposals are adopted, they will enhance the requirements applicable to investment advisers and broker-dealers when they interact with retail investors and help retail investors better understand the differences between investment advisers and broker-dealers, the services they offer and their respective relationships with investors.

The SEC proposals include the following:

- a proposed rule, Regulation Best Interest, that would establish a standard of conduct under the Securities Exchange Act of 1934 (the “Exchange Act”) for broker-dealers when making recommendations to retail customers;
- proposed rules and forms that would require registered investment advisers and broker-dealers to provide a relationship summary to retail investors containing certain prescribed disclosures;
- proposed rules that would prohibit non-dual hatted broker-dealers and their associated natural persons from using the terms “advisor” or “adviser” when acting in a broker-dealer capacity with retail customers and require broker-dealers and investment advisers (and their associated natural persons) to disclose their regulatory status in communications with retail investors;
- a proposed interpretation regarding the standard of conduct applicable to investment advisers; and
- a request for comment regarding whether to impose federal requirements on SEC-registered investment advisers regarding licensing and continuing education for certain employees, delivery of account statements to clients, and financial responsibility.

The proposals are accompanied by extensive requests for comment. The deadline for comments on each of the proposals is August 7, 2018.

I. Regulation Best Interest

After years of studying the question of whether to subject broker-dealers to a fiduciary standard like that applicable to investment advisers, the SEC has proposed “Regulation Best Interest,” that is intended to enhance the standard of conduct for broker-dealers and their associated persons when dealing with retail customers, but stops short of imposing a fiduciary duty.³ The proposed regulation would apply to any broker-dealer, and natural persons who are associated

³ See Regulation Best Interest, Exchange Act Release No. 83062 (Apr. 18, 2018) (the “Best Interest Release”), available at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>.

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persons of a broker-dealer, at the time a “recommendation” is made of a securities transaction or investment strategy involving securities to a retail customer. The proposed regulation would not seek to redefine what constitutes a recommendation, but instead would rely on existing regulatory guidance.⁴ In addition, the best interest obligation would not (i) extend beyond a particular recommendation, (ii) impose a duty to monitor performance of the retail customer’s account, (iii) require a broker-dealer to refuse to accept a customer’s order that is contrary to a broker-dealer’s recommendations, or (iv) apply to an unsolicited transaction by a retail customer who at other times receives recommendations from the broker-dealer.⁵

Currently, recommendations of investments or investment strategies in securities (including recommendations to “hold”) by broker-dealers are required to be “suitable” for their customers;⁶ broker-dealers must have a reasonable basis to believe that their recommendations are suitable, based on reasonable diligence regarding the customer’s “investment profile,” which includes a customer’s age, other investments, financial situation and needs, tax status, investment objectives, investment experience and investment time horizon. The SEC states that the proposed regulation incorporates and goes beyond the current suitability obligations of broker-dealers. However, the SEC also states that although the proposed regulation is designed to enhance investor protection, it is also intended to preserve, to the extent possible, investor choice among a variety of products and services.

The basic tenet of the proposed regulation is that at the time that a broker-dealer or its associated natural person makes a recommendation to a retail customer, the broker-dealer or associated person must act in the retail customer’s best interest without placing the financial or other interest of the broker-dealer or associated person ahead of the customer’s interest. The proposed regulation does not define what the SEC means by “best interest” of the customer, although the

⁴ See Best Interest Release at pp. 72-74. The SEC notes that reliance on existing broker-dealer regulation and rules of the self-regulatory organizations “should provide clarity to broker-dealers and maintain efficiencies for broker-dealers with established infrastructures that already rely on” the definition of recommendation.

⁵ *Id.* at 79-80.

⁶ Under Rule 2111 of the Financial Industry Regulatory Authority, Inc. (“FINRA”), broker-dealers are subject to three different types of suitability obligations when making recommendations to customers: (i) reasonable basis suitability, which requires that a broker-dealer or associated person have a reasonable basis to believe, based on reasonable diligence and an understanding of the potential risks and rewards associated with the security or strategy, that the recommendation is suitable for at least *some* investors; (ii) customer-specific suitability, which requires that a broker-dealer or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer’s investment profile; and (iii) quantitative suitability, which requires a broker-dealer or associated person who has actual or *de facto* control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer’s investment profile. Although it applies to recommendations provided to both retail and institutional investors, Rule 2111 allows broker-dealers and their associated persons to rely on institutional investors to make their own customer-specific suitability determination, subject to compliance with the stated conditions. FINRA has recently proposed amendments to the quantitative suitability obligation under Rule 2111 that would remove the element of control that currently must be proved to demonstrate a violation. See FINRA Regulatory Notice 18-13 (Apr. 20, 2018).

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SEC notes that the standard is different from an investment adviser's fiduciary duty⁷ and from the FINRA "suitability" standard.

The proposed regulation includes a new definition of "retail customer." The SEC's proposed definition is as follows:

a person, or the legal representative of such person, who:

(A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and

(B) Uses the recommendation primarily for personal, family, or household purposes.

Unlike the FINRA definition, which treats natural persons, trusts and other investment vehicles having total assets of \$50 million or more as institutional accounts and not retail customers,⁸ the SEC's proposed definition of "retail customer" does not include any exception for individuals who are sophisticated or wealthy investors. On the other hand, the SEC's definition provides significantly more flexibility than the FINRA definition does to exclude from retail customer status businesses and individuals who invest as part of a business, such as professional traders. Although the SEC does not specifically discuss what type of diligence a broker-dealer would be expected to carry out to categorize an investor as a non-retail investor based on the fact that the person does not use recommendations "primarily for personal, family, or household purposes," neither the proposed rule nor the discussion in the proposing release indicate that reliance on a representation in an account opening form would not be sufficient.

The SEC states that the intent of the proposed regulation is to address the harm associated with broker-dealer incentives to recommend investments and investment strategies in securities for reasons that put the broker-dealer's interest ahead of the customer's interest. The SEC seeks to enhance the investor protections that exist in the current broker-dealer regulatory scheme, while preserving investors' ability to choose to pay for non-discretionary investment advice from a broker-dealer through commissions. The SEC requests comment on, among other things, whether this standard will result in broker-dealers restricting or eliminating product offerings in a manner that could harm customers and reduce their choices.

Under the proposed regulation, a broker-dealer or associated person must do *all* of the following to satisfy its obligations:

⁷ Proposed Commission Interpretation Regarding Standard of Conduct for Investment Adviser; Request for Comment on Enhancing Investment Adviser Regulation, Rel. No. IA-4889 (Apr. 18, 2018) ("IA Interpretation Release") at 5, available at <https://www.sec.gov/rules/proposed/2018/ia-4889.pdf>.

⁸ See FINRA Rule 4512(c).

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- the broker-dealer or associated person must disclose in writing, before or at the time of the recommendation, the material facts relating to the scope and terms of the relationship, including all material conflicts of interest relating to the recommendation;
- in making a recommendation to a retail customer, the broker-dealer or associated person must exercise reasonable diligence, care, skill and prudence;
- the broker-dealer must establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose, or eliminate, all material conflicts of interest arising from incentives that are associated with the specific recommendations to the retail customer; and
- the broker-dealer must establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts arising from financial incentives associated with its recommendations to retail customers (which compliance policies and procedures and supervisory system may be risk-based).

The SEC indicates that the addition of a reasonable standard of care obligation and other requirements to the requirement that conflicts of interest be fully disclosed at or prior to the point of sale is an enhancement beyond the current suitability requirement.

The SEC explains that these duties would augment existing requirements that broker-dealers and their associated persons must meet, and that scienter, fraud or deceit would not be necessary for there to be a violation of the proposed regulation. The SEC asserts that it is not creating a new private right of action or right of rescission in relation to the proposed regulation. Nor is the proposed regulation intended to prohibit broker-dealers or their associated persons from having any conflicts of interest or financial incentives in connection with their recommendations. Rather, the SEC states that various practices that involve conflicts would be permissible to the extent the broker-dealer satisfies the specific requirements of the regulation, that would be enforced by the SEC and FINRA. The SEC notes that the standard of conduct would not be waivable or able to be narrowed by contract.

Proposed Regulation Best Interest would impose extensive new recordkeeping requirements on broker-dealers. Under the proposed regulation, broker-dealers would be required to collect and maintain for the required six-year time period, in the required form, a record of all information collected from and all information provided to each retail customer, in satisfaction of the best interest standard, regarding each recommendation made to the retail customer, as well as a record of the associated person responsible for the account.

The release includes extensive requests for comment about each element of the proposed regulation, as well as on the general standard of conduct. The SEC also seeks comment about whether a broker-dealer's exercise of investment discretion should be viewed as solely incidental to brokerage under Section 202(a)(11)(C) of the Investment Advisers Act

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of 1940, as amended (“Advisers Act”).⁹ The SEC notes that the “quintessentially supervisory or managerial character of investment discretion warrants the protection of the Advisers Act.” In light of the proposed Regulation Best Interest and the proposed new disclosure requirements, the SEC indicates that it believes it would be appropriate to again consider the scope of the broker-dealer exclusion with regard to a broker-dealer’s exercise of investment discretion.

II. Proposed Relationship Summary

The SEC has also proposed new rules that would require broker-dealers and registered investment advisers to provide to “retail investors” a written relationship summary on new Form CRS.¹⁰ The relationship summary is intended to inform retail investors about the relationships and services that the firm offers, the applicable standard of conduct, fees and expenses that the retail investor will pay, certain conflicts of interest, and whether the firm or its associated persons have reportable legal or disciplinary events.

The definition of the term “retail investor” in these proposed rules, which is different from both the FINRA definition and the definition of retail customer in proposed Regulation Best Interest, appears to encompass only natural persons and their direct investment vehicles and not business entities. The proposed definition is as follows:

a client or prospective client who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.

Like the definition of “retail customer” in proposed Regulation Best Interest, the definition of “retail investor” does not exclude investors based on wealth or sophistication. Broker-dealers and registered investment advisers that do not have retail investor clients or customers would not be required to prepare or file a relationship summary.

Broker-dealers would complete Form CRS and file it on the SEC’s Electronic Data Gathering, Analysis and Retrieval System. Registered investment advisers would be required by proposed new Part 3 of Form ADV to complete Form CRS and would file it with that form. Each firm’s Form CRS would be available on the SEC’s public disclosure website. Firms must update their relationship summaries within 30 days of the time they become materially inaccurate. A firm would be

⁹ Section 202(a)(11)(C) excludes from the definition of “investment adviser” any broker or dealer “whose performance of such services [i.e., advising others for compensation about investments in securities] is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” In 2005, the SEC adopted an interpretive rule that, among other things, provided that broker-dealers were not excluded from the Advisers Act for any accounts over which they exercise more than temporary or limited investment discretion. In 2007, the rule was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on grounds related to other parts of the rule. After that rule was vacated, in 2007 the SEC proposed a new rule regarding exercise of investment discretion by broker-dealers.

¹⁰ Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Exchange Act Release No. 83063 (Apr. 18, 2018) (the “CRS Proposing Release”), available at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>.

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required to post the current version on its website (if it has one) or, if it does not have a website, the firm would be required to maintain a toll-free phone number for investors to call to obtain its relationship summary and other documents.

The proposed rule does not address how obligations for completion and delivery of Form CRS should be allocated between an introducing broker and its clearing broker-dealer, but asks for comments on whether the responsibility should be addressed in the applicable clearing agreement required by FINRA Rule 4311, and whether only one form should be required rather than two in this situation.

As proposed, Form CRS would be subject to strict requirements regarding format, length and content. The document may be no more than four pages long, and must adhere to a prescribed format. The SEC proposes to require that the form be written using “plain language” principles, and encourages the use of embedded hyperlinks and other methods to direct retail investors to additional disclosures outside the confines of the form. For certain items, firms would have flexibility in how they respond, but for other items firms would have to use wording prescribed by the SEC.

Among other things, the proposed form would require firms to provide information regarding the relationships and services the firm offers, general details (but not specific ranges) regarding brokerage and advisory fees charged, disclosure regarding “indirect fees” incurred by investors as a result of investments such as mutual funds, variable annuities and exchange-traded funds, and general statements about the firm’s revenue sharing arrangements, noting that the firm has an incentive to offer or recommend certain investments because it receives revenue sharing and providing examples of the types of investments to which revenue sharing applies. In the event that a firm has financial professionals for whom disciplinary events are reported on their Forms U4, U5 and U6, the firm must note the existence of the disciplinary events on Form CRS unless the events are not otherwise released through BrokerCheck or the Investment Adviser Public Disclosure website.

On the other hand, Form CRS - which is also referred to as a relationship summary - and its use of prescribed language provides a way for financial intermediaries to describe their services in a clear manner that may be less likely to be subject to challenge in litigation or arbitration because the phrasing is mandated and provided by the SEC. In addition, whereas in the past, brokerage customers have often brought actions against their financial intermediaries claiming that the intermediary owed the customer certain duties, such as the duty to monitor the customer’s account, to the extent that a pre-set form is used across the industry and is required to include a description of the responsibilities to be performed by the intermediary, the result may be to avoid misunderstandings regarding the scope of the services and, thereby, mitigate litigation risk.¹¹

¹¹ For example, the CRS Proposing Release contemplates that a broker-dealer could expressly inform customers regarding whether the services did or did not include an undertaking to monitor the customer’s account activity. *Id.* at 35 (“The proposed introductory paragraph sets up a key theme of the relationship summary – helping retail investors to understand and make choices among account types and services. For example, some

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A registered investment adviser would be required to deliver a relationship summary to each retail investor before or at the time it enters into an investment advisory agreement. A broker-dealer would be required to deliver a relationship summary before or at the time a retail investor first engages the firm's services. A dual registrant would be required to deliver a relationship summary at the earlier of entering into an investment advisory agreement or the retail investor's engaging its services. As for existing clients or customers that are retail investors, they would be required to be furnished with a relationship summary before or at the time a new account is opened or changes are made to an account that materially change the nature and scope of the firm's relationship with the retail investor. The SEC defines these changes broadly to include: a recommendation that a retail investor transfer from an investment advisory account to a brokerage account and vice versa, asset transfers due to an IRA rollover, deposits or the investment of monies based on infrequent events or of unusual size, such as an inheritance or receipt of proceeds from a property sale, or a significant migration of funds from savings to an investment account. Firms may deliver the relationship summary to retail investors electronically, following the SEC's existing guidance on electronic delivery.

Broker-dealers and registered investment advisers will be required to maintain records evidencing delivery of Form CRS to investors as well as copies of the form itself in accordance with Rules 17a-3 and 17a-4 under the Exchange Act and Rule 204-2 under the Advisers Act, as applicable.

The SEC's requests for comment cover the form in general and its filing and delivery, as well as the format and specific disclosure items proposed.

III. Additional Disclosure Proposals

The SEC has proposed two requirements aimed at ensuring that retail investors understand whether a firm with which they are dealing is an investment adviser or a broker-dealer, and whether the individual from whom they are receiving services is associated with one or the other (or both).¹² Like Form CRS, the disclosure should benefit both retail investors and financial intermediaries by providing clarity regarding the nature of the relationship between the investor and the intermediary and the nature of the services provided. These proposals reference the same definition of "retail investor" used in connection with the proposed Form CRS relationship summary. Several requests for comment accompany each of these proposals.

First, the SEC proposes to prohibit non-dually registered broker-dealers or natural persons associated with a broker-dealer from using the words "adviser" or "advisor" as part of a name or title in communications with a retail investor (e.g.,

retail investors want to receive periodic recommendations while others prefer ongoing advice and monitoring.") and at 39 ("While broker-dealers do not undertake to provide investment strategy and performance monitoring services when they give recommendations, we recognize that many broker-dealers offer these services to retail investors as part of their account agreement. We believe that retail investors would benefit from disclosure that such services exist, and that broker-dealers might charge higher fees for these services.").

¹² See CRS Proposing Release.

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“ABC Adviser” or “financial advisor”). The SEC proposes to except firms that are registered as investment advisers with the SEC or a state, and any associated natural person who is a supervised person of a federal or state registered investment adviser and provides investment advice on behalf of that investment adviser.

The proposed restriction would apply to associated persons of a dual registrant who only provide brokerage services on behalf of the firm, but not to associated persons who are also supervised persons of an investment adviser and provide investment advice to retail investors on behalf of the investment adviser, even if the individuals are dual hatted and also act as associated persons of the broker-dealer. The SEC states that the determination of whether the restriction applies to a dual hatted individual would not depend on the capacity in which the individual is acting at a particular time or the capacity in which he or she serves a particular investor. In selecting this approach, the SEC notes that it believes that it might provide “more certainty and clarity to broker-dealers” as compared with a more principles-based approach that seeks to determine whether a financial intermediary is “holding [itself] out” as an investment adviser.¹³

Second, the SEC has proposed that broker-dealers and registered investment advisers (and their respective associated persons and/or supervised persons) be required to prominently disclose their registration status with the SEC as a broker-dealer or investment adviser (or associated person or supervised person), as applicable, in print or through electronic communications with retail investors.

IV. Proposed Interpretive Guidance

The SEC has proposed an interpretation of the standard of conduct for investment advisers under the Advisers Act. In the IA Interpretive Release, the SEC provides its views on an investment adviser’s fiduciary duty and requests comment on three potential enhancements to advisers’ existing fiduciary obligations drawn from the current broker-dealer regulatory framework that “provides investor protections that may not have counterparts in the investment adviser context.”¹⁴ The SEC’s proposed interpretation is not intended to be the exclusive resource for understanding an adviser’s fiduciary duty. However, some questions have been raised regarding the legal authority supporting the SEC’s proposed interpretive guidance.¹⁵

The SEC references the U.S. Supreme Court’s decision in *Capital Gains*¹⁶ for its conclusion that the Advisers Act establishes a federal fiduciary standard for investment advisers. The SEC notes that although this federal fiduciary duty is

¹³ *Id.* at 181.

¹⁴ IA Interpretive Release at 5.

¹⁵ See, e.g., SEC Commissioner Michael S. Piwowar, *Statement at Open Meeting on Form CRS, Proposed Regulation Best Interest and Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers (Proposed Rule)*, Apr. 18, 2018, available at <https://www.sec.gov/news/public-statement/statement-piwowar-041818>.

¹⁶ SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

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not specifically defined in the Advisers Act or the rules thereunder, it is imposed by the antifraud provisions of Section 206 of the Advisers Act. The SEC states that while the relationship between an investment adviser and a client may be shaped by contract, “the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty.”¹⁷

The SEC summarizes the fiduciary duty of investment advisers as consisting of the duty of care and the duty of loyalty. Focusing on the duties arising when an investment adviser provides personalized investment advice to clients, the SEC states that an investment adviser’s duty of care consists of three separate duties.

First, an adviser must act and provide advice that is in the client’s best interest. The proposed interpretation includes a discussion of the steps that the SEC says are necessary for an adviser to fulfill this obligation, including gathering and updating information about the client that will form the basis for determining whether the advice given is suitable for and in the client’s best interest based on the client’s “investment profile,” as well as the importance of the costs associated with investment advice. The SEC defines “investment profile” differently from FINRA and focuses on the client’s personal and financial information, including current income, investments, assets and debts, marital status, insurance policies and financial goals.¹⁸ In this context (unlike Regulation Best Interest), the SEC contemplates that suitability obligations vary depending upon the sophistication and goals of the investor.¹⁹ The SEC also recognizes that fiduciary duty does not require an adviser to recommend the lowest cost investment product or strategy, but it also states that it would be contrary to an adviser’s fiduciary duty for the adviser to select a higher cost product if the lower cost product was otherwise identical.²⁰

Second, an investment adviser has a duty to seek best execution of trades for clients when it is responsible for selecting broker-dealers to execute the trades. In that regard, the SEC notes that an adviser must consider “the full range and quality of a broker’s services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness” to the adviser.²¹

¹⁷ See IA Interpretive Release at text accompanying n.21. As with certain other assertions in the proposed interpretation, the SEC did not cite any statutory authority for this. The SEC’s citations include secondary sources such as a treatise (Tamar Frankel, Arthur Laby & Ann Schwing, *The Regulation of Money Managers* (updated 2017)), a Restatement (Restatement (Third) of Agency, § 8.06 Principal’s Consent (2006)), and letters received by the SEC in response to previous requests for comment.

¹⁸ *Id.* at 10.

¹⁹ *Id.* at 11 (“When advising a financially sophisticated investor with a high risk tolerance, . . . it may be consistent with the adviser’s duties to recommend investing in such directionally speculative derivatives or investing in securities on margin.”).

²⁰ *Id.* at 12.

²¹ *Id.* at 14.

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Third, the proposed interpretation states that an investment adviser has a duty to provide advice and monitoring over the course of a relationship with a client. The SEC notes, however, that this duty may be circumscribed by contract in some circumstances, such as financial planning.

In discussing an investment adviser's duty of loyalty, the SEC emphasizes that an adviser must not favor its own interests over those of a client or unfairly favor one client over another. However, the SEC notes that allocating investment opportunities among clients does not mean that an adviser must have a *pro rata* allocation policy, that the adviser's allocation policies cannot reflect the differences in clients' objectives or investment profiles, or that the adviser cannot exercise judgment in allocating investment opportunities among clients. An investment adviser has a duty to disclose to its clients all material facts relating to the advisory relationship. While saying that an adviser has a duty to seek to avoid conflicts of interest with its clients and, at a minimum, make full and fair disclosure of material conflicts of interest, the SEC also asserts that disclosure of a conflict alone is not always sufficient to satisfy an investment adviser's duty of loyalty and Section 206 of the Advisers Act. In particular, the SEC notes that some conflicts may be too complex or extensive for an adviser to be able to provide sufficiently specific and understandable disclosure to clients. In such cases, the SEC states that disclosure alone would be insufficient and the adviser would be required to "eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed." The SEC does not provide parameters for assessing whether a conflict has been adequately mitigated.

The SEC requests comment regarding whether its proposed interpretation provides sufficient guidance regarding investment advisers' fiduciary duty, whether there are significant issues relating to fiduciary duty that the interpretation has not addressed, and whether the SEC should codify any portions of the interpretation in rules under Section 206.

V. Possible New Advisers Act Requirements

The IA Interpretive Release also set out three areas in which the SEC is considering new regulatory requirements to impose on investment advisers. The SEC frames this discussion as intended to further the harmonization of regulation as between investment advisers and broker-dealers and to enhance the investor protections provided to investment advisory clients.

Licensing and Continuing Education

The SEC is considering whether investment adviser personnel should be subject to federal licensing and continuing education requirements. The SEC notes that while most states require investment adviser representatives who have a place of business in the state to be registered, licensed and/or meet certain other qualifications, and FINRA requires that associated persons of broker-dealers register and meet qualification requirements, there is no comparable federal requirement for investment adviser representatives of SEC-registered investment advisers. The SEC asks for comment about these potential requirements.

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Advisory Account Statements

The SEC is also considering whether registered investment advisers should be required to provide clients with periodic account statements, either directly or through the client's custodian, regardless of whether the adviser is deemed to have custody of client assets under Advisers Act Rule 206(4)-2 or is a sponsor of a managed account program relying on the safe harbor in Rule 3a-4 of the Investment Company Act of 1940, as amended. The SEC notes that there is currently no requirement under the Advisers Act for investment advisers to do so, whereas broker-dealers are required to deliver transaction confirmations and account statements to customers under the Exchange Act, FINRA and other rules.²² The SEC asks for comment with respect to the delivery of account statements.

Financial Responsibility

Finally, the SEC asks whether registered investment advisers should be subject to financial responsibility requirements. The SEC notes that broker-dealers are subject to comprehensive financial responsibility requirements under the Exchange Act and FINRA rules, including net capital and customer protection rules, an annual audit requirement, and a fidelity bonding requirement, and are required to be members of the Securities Investor Protection Corporation. The SEC asks for comment on whether investment advisers should be subject to similar requirements. The SEC also notes that investment advisers are not currently required to report information about their own assets and asks for comment on whether advisers (including privately held advisers) should be required to provide such information on Form ADV and to obtain annual audits of their financials.

VI. Conclusion

The proposals reflect the culmination of a long process intended to enhance the protection of retail investors, whether they are serviced by a broker-dealer or a registered investment adviser, and seeks to build upon existing broker-dealer regulatory obligations under the federal securities laws and FINRA rules. The proposed disclosure requirements and Regulation Best Interest represent a very different approach from that provided by the DOL Fiduciary Rule,²³ which was recently voided by the Fifth Circuit Court of Appeals.²⁴ Although it is too early to predict what the final rules will look like, the approach followed by the proposals allows intermediaries flexibility to agree contractually with their clients regarding the scope of the services to be provided while subjecting financial intermediaries to heightened disclosure requirements – particularly with respect to conflicts of interest – and enhancements to the established FINRA principles requiring broker-

²² The SEC notes that under Advisers Act Rule 206(4)-2, an investment adviser with custody of client funds or securities must have a reasonable belief that the qualified custodian sends the client an account statement at least quarterly, and that in separately managed account programs relying on Rule 3a-4 under the Investment Company Act of 1940, clients must receive a statement at least quarterly from the sponsor or another person designated by the sponsor.

²³ 29 CFR 2510.3-21 (effective June 9, 2017).

²⁴ *Chamber of Commerce of the U.S.A., et al. v. U.S. Dep't of Labor, et al.*, No. 17-10238 (Fifth Cir.) (Mar. 15, 2018).

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dealers to “deal fairly” with customers and to provide recommendations consistent with a retail customer’s investment profile. In addition, the package of proposals focuses primarily on regulation of investment advisory services provided by broker-dealers and registered investment advisers and not on non-advisory services provided by broker-dealers, such as execution brokerage or custody. By establishing a prescribed form and pre-set language to address specific situations, the proposed rules may not only provide useful information and protections to retail investors, but may also help to establish legal certainty and to mitigate litigation risk for financial intermediaries.

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