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DEVELOPMENTS IN THE REGULATION OF FIDUCIARY INVESTMENT ADVICE

Earlier this year, the SEC released extensive proposals seeking industry input on existing standards of care for investment advisers and broker/dealers serving retail investors and on the implementation of new standards. The authors describe the history and current status of the DOL fiduciary rule that the SEC proposals would replace and then turn to a detailed exploration of the proposals and the initial response to them. They close with an overview of state-level developments affecting fiduciary investment advice.

By Gwendolyn A. Williamson, Matthew S. Williams, and Thomas M. Ahmadifar *

Investment advisers and broker/dealers today are operating in an industry severely disrupted by shifting regulations and customer preferences. The fiduciary standards of the widely contested rule amendments adopted by the U.S. Department of Labor (the "DOL") in April 2016 (the "DOL Fiduciary Rule" or "the Rule") transformed the way mutual funds and other investment products and services are priced and sold by asset managers. It also introduced the complexities of the DOL's prohibited transactions and conditional exemption framework into compliance programs across the industry. Now, the Rule has been abandoned mid-implementation, and the SEC has offered an alternative regulatory structure with a reinterpretation of the existing fiduciary standards for investment advisers, new conduct standards for broker/dealers, and related disclosure and other rules proposed in April 2018 (the "SEC Proposals"). The final form of the SEC Proposals (currently weighing in at around 1,000 pages and over 1,800 footnotes) and the question of whether the SEC will eventually adopt them remain uncertain, as does the fate of the DOL Fiduciary Rule. In the background, some states have taken matters into their own hands, proposing or adopting regulations and pursuing enforcement actions around fiduciary investment advice.

This article traces the recent history of the DOL Fiduciary Rule, explores the SEC Proposals and the initial response to them, and provides an overview of state-level developments affecting fiduciary investment advice. It also suggests some ways that asset management firms might, as appropriate, proactively address these developments.

I. THE END OF THE DOL FIDUCIARY RULE?

The DOL Fiduciary Rule, adopted in April 2016 near the end of the Obama Administration, expanded the

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definition of "fiduciary" under the Employee Retirement Income and Security Act of 1974 ("ERISA") to cover a wider range of market actors and significantly changed how ERISA applied to asset management businesses.[1] The Rule was intended to protect retirement investors by expanding the definition of "investment advice fiduciary," and subjecting many more investment advisers and other financial intermediaries to ERISA fiduciary standards and prohibitions on transactions involving self-dealing and other conflicts of interest.[2]

The DOL Fiduciary Rule deemed an individual or firm to be an "investment advice fiduciary" if they rendered investment advice to retirement investors for a fee. It also precluded these fiduciaries from receiving separate variable rate compensation tied to retirement investors' choices in response to recommendations made by the fiduciary "as to the advisability of" buying, selling, holding or exchanging "investment property" ("commissions").[3] Conditional "best interest contract" ("BIC") and principal transaction exemptions were available under the Rule for investment advice fiduciaries hoping to continue charging commissions on client transactions.[4] But the Rule's prohibited transaction provisions shined a spotlight on the potential conflicts of interest inherent in variable commission rates, and drove investment advice fiduciaries to migrate to fee-based compensation models for many of their client transactions .

With the Rule originally set to become fully effective on April 10, 2017, by late 2016 financial intermediaries were modifying the pricing structures of distribution platforms and mutual funds and their advisers were implementing share class changes in anticipation of complying. Firms covered by the Rule as investment advice fiduciaries adopted policies and procedures designed to prevent them from running afoul of the impartial conduct standards embedded in the BIC and principal transaction exemptions that required them to act in clients' best interest, charge reasonable compensation, seek the best execution available, and not make misleading statements.[5] A February 3, 2017 executive memorandum from President Trump addressed to the Secretary of Labor requested a review of the key provisions of the DOL Fiduciary Rule, and noted that it might "not be consistent with the policies of [the] Administration."[6] In April 2017 the DOL delayed full compliance with the Rule to January 1, 2018, and set June 9, 2017 as the effective date for certain provisions,

[1] ERISA is intended to protect employee benefit plan participants and their beneficiaries. It is administered by the DOL through the Employee Benefit Security Administration.

[2] *Definition of the Term "Fiduciary;" Conflicts of Interest Rule—Retirement Investment Advice*, 81 Fed. Reg. 20,946 (Apr. 8, 2016). The DOL Fiduciary Rule entailed a variety of rulemaking. *See id.*, 81 Fed. Reg. 21,002, 81 Fed. Reg. 21,089, 81 Fed. Reg. 21,139, 81 Fed. Reg. 21,147, 81 Fed. Reg. 21,181, 81 Fed. Reg. 21,208 (Apr. 8, 2016). The combined rulemaking, referred to collectively as the DOL Fiduciary Rule, was the result of a far-from-straightforward process that began in 2010 and included two separate rule proposals with attendant comment periods (one of which was withdrawn and re-proposed in part), as well as multi-day public hearings; during the extended rulemaking period, the SEC also conducted similar roundtables and issued statements on the topic.

[3] 81 Fed. Reg. 20,946.

[4] *Best Interest Contract Exemption*, 81 Fed. Reg. 21,002, 21,002–03 (Apr. 8. 2016) (stating that the BIC exemption permits individual advisers and related financial institutions "to receive commissions and other common forms of compensation,

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provided that they implement appropriate safeguards against the harmful impact of conflicts of interest on investment advice," and discussing throughout in further detail the precise conditions and safeguards that must be met). The DOL Fiduciary Rule also amended the class-level prohibited transaction exemptions (each, a "PTE") under ERISA for all securities transactions involving employee benefit plans and broker/dealers ("PTE 84-128"), certain classes of transactions involving employee benefit plans and certain broker/dealers, reporting dealers, and banks ("PTE 75-1"), and all proprietary transactions involving insurance agents and brokers, pension consultants, insurance companies, and investment company principal underwriters ("PTE 84-24").

[5] *See* DOL Field Assistance Bulletin 2017-02 (May 22, 2017).

[6] Presidential Memorandum on Fiduciary Duty Rule (Feb. 3, 2017), *available at* https://www.whitehouse.gov/presidential-actions/presidential-memorandum-fiduciary-duty-rule [hereinafter "White House Memo"].

including (importantly) the "impartial conduct standards" for investment advice fiduciaries.[7] Then in November, the DOL delayed the effective date for full compliance with the Rule for an additional 18 months to January 1, 2019.[8] Among its reasons for the delay, the DOL cited the costs of compliance for, and ongoing disruption of, the asset management industry.[9] Meanwhile, legal challenges to the DOL Fiduciary Rule in the courts carried on apace until a pair of cases first created ambiguity and then stopped the countdown to full effectiveness of the Rule in its tracks.

On March 13, 2018, the U.S. Court of Appeals for the Tenth Circuit upheld key components of the DOL Fiduciary Rule in its decision in *Market Synergy Group, Inc. v. U.S. Department of Labor*.[10] The Tenth Circuit determined that the DOL had satisfied its regulatory burden under the Administrative Procedures Act (the "APA") and therefore the particular DOL actions raised on appeal were not arbitrary or capricious.[11]

Two days later, however, on March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit vacated the DOL Fiduciary Rule in its entirety in *Chamber of Commerce of the United States of America v. U.S. Department of Labor*.[12] The Fifth Circuit noted that the U.S. Supreme Court has been skeptical of federal regulations crafted from long-standing statutes empowering federal agencies to exert "novel" and "extensive" power over the American economy.[13] It held that the Rule's definition of "investment advice fiduciary" was overly broad, and among other things, conflicted with existing ERISA provisions, was unreasonable, and could not pass muster under the APA, in part because it impermissibly brought financial intermediaries without trust-and-confidence-based client relationships under its control via "backdoor regulation."[14] The Fifth Circuit held that the *entirety* of the DOL Fiduciary Rule as a "comprehensive regulatory package" was "plainly not amenable to severance," and issued a decision to vacate the DOL Fiduciary Rule *in toto*.[15]

For the sake of argument, we will assume that the Fifth Circuit and Tenth Circuit opinions have *not* caused

[7] 82 Fed. Reg. 16,902 (Apr. 7, 2017). Of note, in June 2017 the U.S. House of Representatives passed the Financial Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs Act of 2017 (the "CHOICE Act"), which was intended to repeal the DOL Fiduciary Rule and give the SEC jurisdiction over any fiduciary standard for investment advisers, broker/dealers and others covered by the Rule, and was generally consistent with the Core Principles for Regulating the United States Financial System as outlined by President Trump in materials released the same day as his February 2017 executive memo. H.R. 10, 115th Cong. § 841 (2017-2018); H.R. 5983, 114th Cong. § 441 (2015-2016). H.R. 10 passed the House of Representatives on June 8, 2017, and as of August 30, 2018 had been referred to the Senate Committee on Banking, Housing, and Urban Affairs, which last held a hearing regarding the CHOICE Act on July 13, 2017. In October 2017, the U.S. Department of the Treasury expressed its support of the mandated reexamination of the Rule and the delay of its effectiveness until a myriad of articulated issues could be resolved. It also opined that further efforts to harmonize the standard of conduct for financial intermediaries should involve only the SEC and the states, and that, generally, conflicts of interest in the asset management space should be resolved to afford investors the greatest possible access to a wide variety of asset classes, investment products, distribution channels, and other possibilities. DEP'T OF TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: ASSET MANAGEMENT AND INSURANCE 10 (2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf.

[8] 82 Fed. Reg. 56,545 (Nov. 29, 2017).

[9] *Id.*

[10] 885 F.3d 676 (10th Cir. 2018), *slip. op. available at* https://www.ca10.uscourts.gov/opinions/17/17-3038.pdf. The Tenth Circuit concluded that: (1) the DOL provided adequate

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notice of its intention to exclude transactions involving fixed-income annuities ("FIAs") from PTE 84-24, the class exemption that allows commissions to be charged on sales of non-FIA annuities under certain conditions; (2) the Rule did not improperly treat FIAs differently from other annuities by excluding FIAs from PTE 84-24; and (3) the DOL adequately considered the economic impact of its exclusion of FIAs from PTE 84-24.

[11] *Id.* at 685–86.

[12] 885 F.3d 360 (5th Cir. 2018), *slip op. available at* http://www.ca5.uscourts.gov/opinions/pub/17/17-10238-CV0.pdf.

[13] *Id.* at 387 (citing *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015)).

[14] *Id.* Like the Tenth Circuit, the Fifth Circuit referred to APA provisions requiring that "a reviewing court shall . . . hold unlawful and set aside agency action . . . found to be . . . arbitrary, capricious . . . not in accordance with the law" or "in excess of statutory . . . authority . . . or limitations." *Id.* at 388 (quoting APA, 5 U.S.C. § 706(2)(A), (C) (2017)).

[15] *Id.*

a circuit split, since the Fifth Circuit went further than the Tenth Circuit by asserting a nationwide injunction. While the Supreme Court has not directly addressed the issue, the longstanding view is that federal appellate and district courts can issue such injunctions.[16] The Fifth Circuit issued its final order on June 21, 2018, and the DOL has acknowledged the impairment of the Rule's status by the Fifth Circuit's decision.[17] Unsurprisingly, the DOL did not appeal to the Supreme Court by the June 13, 2018 deadline.[18] Additional litigation seems unlikely in the near term.

Still, without any on-point Supreme Court precedent, and the potential for facts on the ground and the interplay among the various branches of the federal government to change, asset managers are not likely to say their final farewells to the DOL Fiduciary Rule just yet. And for many firms that have already fully adopted mutual fund share class, investor services pricing, and/or other foundational changes, the vacatur of the Rule might have minimal effect, given the extensive resources deployed in anticipation of satisfying the Rule.[19]

II. THE BEGINNING OF A NEW "BEST INTEREST" ERA AT THE SEC?

The concept of harmonizing and otherwise updating the conduct standards applicable to investment advisers and broker/dealers was discussed for nearly thirty years by the asset management industry and its primary regulator, the SEC, before the current SEC Proposals were released on April 18, 2018.[20] Section 913 of the Dodd-Frank Act cleared the path for the SEC to engage in an undertaking like the SEC Proposals by first mandating a study to evaluate the existing standards of care for investment advisers and broker/dealers serving retail investors, and then granting the SEC the authority to implement new standards of care.[21] SEC Chairman Jay Clayton repeatedly called the rulemaking a priority beginning in 2017 and requested input on it from industry participants.[22] In June 2017 Clayton asked, alluding to the February 2017 White House Memo, for comments on whether the DOL Fiduciary Rule would cause, or already had caused: (1) a harmful reduction of Americans' access to retirement savings offerings, retirement product structures, retirement savings information, or related financial advice; (2) disruption within the retirement services industry with adverse effects for investors or retirees; (3) an increase in litigation; and/or (4) higher access costs for retirement services.[23]

The SEC Proposals were released in April 2018 at an SEC open meeting[24] where several Commissioners expressed sharp disagreement with some or all of the provisions being proposed and released for public comment.[25] In essence, the SEC Proposals, without

[16] Zayn Siddique, *Nationwide Injunctions*, 117 COLUM. L. REV. 2095 (2017).

[17] DOL Field Assistance Bulletin 2018-02 (May 7, 2018).

[18] 28 U.S.C. §§ 1254, 2101(c).

[19] *See, e.g.*, William A. Birdthistle & Daniel J. Hemel, *Next Stop for Mutual-Fund Fees: Zero*, WALL ST. J. (June 10, 2018); *see also* Emily Laermer, *"Triple Zero" Clean Share Launches (Despite Death of the DOL Rule)*, IGNITES.COM (Aug. 6, 2018) (citing Robin Wigglesworth, *Fidelity's no-fee fund triggers mix of alarm and calls for calm*, FIN. TIMES (Aug. 6, 2018)).

[20] *See, e.g.*, DIV. OF INV. MGMT., SEC. & EXCH. COMM'N, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION (1992), *available at* https://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf.

[21] It is also noteworthy that under Section 913 of the Dodd-Frank Act, the SEC must not impose a less stringent standard of conduct on broker/dealers than on investment advisers. Pub. L. 111-203, § 913, 124 Stat. 1376, 1824-30 (2010).

[22] *See, e.g.*, Jay Clayton, Chairman, Sec. & Exch. Comm'n, Public Statement, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017), *available at* https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31#_edn1.

[23] *See id.*; *see also* White House Memo, *supra* note 6.

[24] Meeting Notice, 83 Fed. Reg. 16,416 (Apr. 16, 2018). The SEC has received comments on appropriate fiduciary standards and has routinely held roundtables and hearings and collected comments on various aspects of fiduciary investment advice since ERISA was adopted (frequently relating to exemptions from investment adviser registration requirements).

[25] *See, e.g.*, Kara M. Stein, Comm'r, Sec. & Exch. Comm'n, *Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers* (Apr. 18, 2018) (indicating that the proposal "does not define what best interest means" and posing, among related questions for public input: "Should the Commission's proposal define what 'best interest' means?"); Robert J. Jackson, Jr., Comm'r, Sec. & Exch. Comm'n, *Statement on Proposed Rulemakings and Interpretations Relating to Retail Investor Relationships with Investment Professionals* (Apr. 18, 2018) (similarly opining that the proposed standard is "far too ambiguous about a question on which there should be no confusion"). *But see*

defining the term "best interest," would require broker/dealers making investment recommendations to act in and prioritize customers' best interest.[26] They would require certain investment advisers, broker/dealers, and dual-registered firms to deliver standardized "relationship summary" disclosures on new Form CRS.[27] The SEC Proposals also include a proposed interpretation clarifying the scope of the fiduciary duty applicable to investment advisers under the Advisers Act.[28] There are three main releases, each of which we examine in turn.

A. The Reg BI Release

Reg BI — Background and Summary of Proposed Requirements. Proposed Regulation Best Interest ("Reg BI") would establish a "standard of conduct" for broker/dealers,[29] which, as noted, was mandated by the Dodd-Frank Act to be "no less stringent" than that imposed under the Advisers Act in any SEC rulemaking.[30] Importantly, the Reg BI Release affirms that the SEC is "not proposing a uniform fiduciary standard under Section 913(g) [of the Dodd-Frank Act],"[31] citing the SEC staff study of investment advisers and broker/dealers required by Section 913 of the Dodd-Frank Act (the "913 Study"),[32] comments received in response to Chairman Clayton's June 2017 remarks, and other considerations, such as the differences in broker/dealers' and investment advisers' business models.

Broker/dealers, as Financial Industry Regulatory Authority ("FINRA") members, are currently subject to "suitability" standards applicable to FINRA members or associated persons dealing with retail investors, which require such brokers-dealers to have:

> [A] *reasonable basis* to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.[33]

The suitability analysis is highly fact-dependent, and the Reg BI Release acknowledges that upending the suitability standard could confuse broker/dealers.[34] The Reg BI Release also notes that while past interpretations

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Brett Redfarn, Dir., SEC Division of Trading & Markets, Remarks at the Annual FINRA Conference, Washington, D.C. (May 23, 2018) (generally answering the question "[w]hat does it mean to act in a customer's best interest?"), *available at* https://www.sec.gov/news/speech/redfearn-remarks-finra-annual-conference-052218.

[26] *Regulation Best Interest*, Exchange Act Release No. 83062 (Apr. 18, 2018), 83 Fed. Reg. 21,574 (proposed May 9, 2018) [hereinafter "Reg BI Release"], *available at* https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

[27] *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. 34-83063; Investment Advisers Act of 1940 (the "Advisers Act") Release No. 4888 (Apr. 18, 2018), 83 Fed. Reg. 21,416 (proposed May 9, 2018), 83 Fed. Reg. 23,848 (corrected May 23, 2018) [hereinafter "Form CRS Release"], *available at* https://www.sec.gov/rules/proposed/2018/34-83063.pdf.

[28] *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation*, Advisers Act Release No. 4889 (April 18, 2018), 83 Fed. Reg. 21,203 (proposed interpretation May 9, 2018) [hereinafter "IA Release"], *available at* https://www.sec.gov/rules/proposed/2018/ia-4889.pdf.

[29] *See generally* Reg BI Release, *supra* note 26.

[30] Dodd -Frank Act, Section 913(g)(1).

[31] *See* Reg BI Release, *supra* note 26, at 47.

[32] *See* STAFF OF THE SEC, SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2011), *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf [hereinafter "913 Study"].

[33] FINRA Rule 2111(a) (emphasis added). The suitability rule is supplemented by various FINRA releases and FAQs, a full discussion of which are outside the scope of this article. *See generally* FINRA Rule 2111 (Suitability) FAQ, *available at* http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq.

[34] *See, e.g.*, Reg BI Release, *supra* note 26, at 6-66.

of the suitability rule have used the term "best interest," such a standard was never explicitly incorporated.[35]

Reg BI seeks to build upon the suitability standard by adding a rule to the Securities Exchange Act of 1934 (the "Exchange Act") that would establish the obligation of broker/dealers to "act in the best interest of [a] retail customer . . . without placing the financial or other interest of" the broker/dealer making a recommendation "ahead of the interest of the retail customer."[36]

The proposed rule would include a "safe harbor" for broker/dealers fulfilling the following specific disclosure, care, and conflict of interest obligations when interacting with a retail customer:

- Material facts regarding the scope and terms of the client's relationship with the broker/dealer, including all related material conflicts of interest, must be disclosed to the customer in writing (disclosure obligation);
- "Reasonable diligence, care, skill, and prudence" must be exercised as necessary for the broker/dealer (i) to understand the product being recommended, and (ii) form a reasonable basis to believe the recommended product is in the customer's "best interest" when considering the retail customer's investment profile (cure obligation); and
- Written policies and procedures reasonably designed to identify, disclose, mitigate, or eliminate material conflicts of interest arising from financial incentives must be established, maintained and enforced (conflicts obligation).[37]

Importantly, customers and broker/dealers could not waive the "best interest" obligation; thus, although the scope of a specific client *engagement* could be defined by contract, the obligations of Reg BI could *not* be reduced by contract.[38]

Reg BI — Key Considerations and Open Questions. In perhaps a tacit acknowledgement that several key terms, such as "recommendation"[39] (and, as noted *supra* by certain Commissioners, the eponymous term "best interest"), may need revision in any final rules, the Reg BI Release poses several targeted questions for commenters' consideration that include:

- Do commenters agree with the SEC's general approach of building on existing (*e.g.*, FINRA) requirements?[40]
- Should the SEC define the term "recommendation" and, if so, should it be defined as described in the Reg BI Release?[41]
- Should the SEC broaden or limit the scope of individuals and firms to whom Reg BI applies (*e.g.*, small business entities such as a sole proprietorship)?[42]

[35] *Id.* at nn. 6, 15 and accompanying text.

[36] *Id.* at 50-51, 405 (text of proposed best interest obligation of Rule 15l-1 under the Exchange Act).

[37] *Id.* at 405-07 (proposed text of safe harbor obligations). *See generally id.* at 96-196 (discussing each of the three obligations in further detail).

[38] *Id.* at 80-81 ("[A] broker-dealer would not be able to waive compliance with the rule's obligation to act in the best interest of the retail customer at the time a recommendation is made

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and the specific obligations thereunder, nor can a retail customer agree to waive her protection under Regulation Best Interest.").

[39] The Reg BI Release interprets "recommendation" pursuant to SEC rules, FINRA rules, and the DOL Fiduciary Rule. *Id.* at 92. Per that interpretation, a "recommendation" is determined along a sliding scale of what could "reasonably . . . be viewed as a call to action" or as what could "reasonably . . . influence an investor to trade a particular security or group of securities." *Id.* at 75-76. The term recommendation also includes *any advice tied to a securities transaction*, including explicit recommendations *not* to trade as well as recommendations to "roll over" assets in an ERISA account to an individual retirement account. *Id.* at 80-83.

[40] *Id.* at 90.

[41] *Id.*

[42] *Id.* at 90. The term "retail customer" under Reg BI would include any person, *or the legal representative of a person*, who (i) 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 (ii) uses the recommendation *primarily* for personal, family, or household purposes. *Id.* at 407 (defining "retail customer" under proposed Rule 15l-1(b) under the Exchange Act). This question from the SEC proposes to expand the class of protected persons, rather than the class of persons required to abide by Reg BI.

- Should Reg BI apply to "impersonal investment advice" as well (such as generalized advice about securities circulated on the internet)?[43]

- What types of costs would this entail, and what delivery methods could mitigate those costs?[44]

Multiple questions regarding the scope of the "safe harbor" disclosure, care, and conflict of interest obligations outlined *supra* are also posed, including:

- Would the disclosure obligation cause a broker/dealer to act in a manner consistent with what a customer would expect to be in his or her "best interest"?[45] Should the SEC promulgate more specific disclosures under this obligation, akin to more formal Form ADV disclosures?[46] Should new disclosures, beyond what are currently required pursuant to state law, the Exchange Act, and FINRA rules, be required?[47] Should dually-registered advisers and broker/dealers be subject to fewer disclosure requirements, extra disclosure requirements, or a different set of disclosure requirements?[48]

- Would the care obligation cause a broker/dealer to act in a manner consistent with what a customer would expect to be in his or her "best interest"?[49] Has the SEC provided sufficient guidance on how broker/dealers can meet the care obligation?[50] Does the proposed care obligation enhance existing suitability obligations?[51] The Reg BI Release does not include certain recommendations of the 913 Study, such as best execution and fair pricing and compensation requirements, due to currently existing standards of conduct for broker/dealers. Are the existing standards sufficient, and should the SEC explicitly expand the care obligation?[52] Should the SEC define "best interest" in Reg BI?[53]

- Would the conflicts obligation cause a broker/dealer to act in a manner consistent with what a customer would expect to be in his or her "best interest"?[54] Do the anti-fraud provisions of the federal securities laws adequately cover non-recommendation-related conflicts that would not be addressed by Reg BI, or should the final rule be expanded to cover any such conflicts?[55] Instead of requiring policies and procedures regarding conflicts of interest, should the SEC simply require broker/dealers to mitigate and disclose conflicts of interest?[56] How broadly should the conflict of interest obligation be applied (*e.g.*, should it cover natural persons associated with broker/dealers)?[57] Should Reg BI require that broker/dealers undergo supervisory and compliance reviews and, if so, of what frequency and scope?[58]

The Reg BI Release also solicits commenters' views on reasonable conflict mitigation measures[59] and record-making/recordkeeping requirements for broker/dealers,[60] and whether the existing exclusion under the Advisers Act for investment advice that is "solely incidental" to the business of a brokerage should be narrowed, tailored, or even eliminated.[61]

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[43] *Id.* at 92 (citing the 913 Study, *supra* note 32, at 123-27).

[44] *Id.*

[45] *Id.* at 125.

[46] *Id.*

[47] *Id.* The questions include specific inquiries regarding the type and extent of fee disclosures that broker/dealers should provide. *Id.* at 150-51.

[48] *Id.* at 150-51.

[49] *Id.* at 161.

[50] *Id.* at 162.

[51] *Id.*

[52] *Id.* The Reg BI Release also suggests the following set of questions as general considerations for broker/dealers in running their businesses, rather than as requests for comments on the proposed rulemaking: Can brokers achieve the same objectives by recommending less risky, costly or complex products? *Id.* at 139. What are the costs and fees associates with a product, and are they sufficiently transparent? *Id.* at 140. Do products present novel legal, tax, market, investment or credit risks to the client? *Id.* How liquid are the products and what are the secondary markets for the products considered for clients? *Id.*

[53] *Id.* at 165 (referencing proposed Rule 15l-1(a)(2)(i)(B) under the Exchange Act).

[54] *Id.* at 189.

[55] *Id.* at 190.

[56] *Id.*

[57] *Id.* at 191.

[58] *Id.*

[59] *See id.* at 195-96 for a full list of these questions.

[60] *Id.* at 199.

[61] *Id.* at 205-07.

B. The Form CRS Release

Form CRS — General Requirements and SEC Templates. The Form CRS Release introduces a new four-page, standardized disclosure document for investment advisers, broker/dealers, and dually registered firms that is intended to provide more user-friendly explanations of the client/customer relationship to retail investors.[62] A "retail investor" would be defined as any natural person or "trust or other similar entity that represents natural persons"—even if another person is a trustee or managing agent of the trust.[63]

Form CRS would provide disclosure in plain English to retail investors about a range of topics, including: registration status of the firm and its financial professionals; services offered (*e.g.*, transaction-based or asset-based); types of expenses associated with the firm and its professionals; legal duties to retail customers; conflicts of interest; disciplinary history of the firm and its professionals; avenues for retail investors to report problems; and additional questions a retail investor should ask his or her financial professional.[64]

Dually-registered advisers-broker/dealers would be required to present side-by-side comparative information regarding advisory and/or broker/dealer relationships. Financial professionals registered in more than one capacity would have to make Form CRS disclosures only in the capacities in which they provide recommendations to retail investors.[65]

The SEC provided "mock-ups" or templates of Form CRS as proposed guideposts for investment advisers,[66] broker/dealers,[67] and dual-registrants[68] in the proposed Form CRS appendices; the Form CRS Release also includes a two-page "tear sheet" intended to educate retail investors about Form CRS.[69]

Form CRS - Other Requirements. The Form CRS Release also lays out additional requirements, including the following:

- *Delivery*: A firm would deliver Form CRS to retail investors (i) for advisers, before or at the time of entering the investment advisory agreement, or (ii) for broker/dealers, before or at the time the investor first engages the firm's services (including placing an order or opening an account). Dual-registrants would deliver Form CRS at the earlier of these two events.[70]

- *Filing*: Each Form CRS would be filed electronically with the SEC, with (i) advisers filing Form CRS as a new Part 3 to Form ADV through the Investment Adviser Registration Depository ("IARD"), and (ii) broker/dealers filing Form CRS electronically via the SEC's electronic data gathering and retrieval ("EDGAR") system in a text-searchable format. Dual-registrants would file through EDGAR and the IARD.[71]

- *Updating*: All firms would update Form CRS within 30 days of any material change and communicate the change to retail customers. This would include material changes to "the nature and scope" of the adviser's relationship with a retail investor, including any recommendation made outside "the normal, customary, or already agreed course of dealing" to switch from an advisory account to a brokerage account (or vice versa) or to move assets from one type of account to another.[72]

- *Recordkeeping*: Firms would be required to retain copies of Form CRS, and additionally preserve a record of dates on which each Form CRS was delivered to any client or prospective client who subsequently becomes a client (advisers for five years, broker/dealers for six) per proposed

[62] *See generally* Form CRS Release, *supra* note 27.

[63] *Id* at n.30 and accompanying text; Form CRS General Instruction 9(d).

[64] Form CRS, Appendix B (Instructions), *available at* https://www.sec.gov/rules/proposed/2018/34-83063-appendix-b.pdf.

[65] *Id*.

[66] Form CRS, Appendix E, *available at* https://www.sec.gov/rules/proposed/2018/34-83063-appendix-e.pdf.

[67] Form CRS, Appendix D, *available at* https://www.sec.gov/rules/proposed/2018/34-83063-appendix-d.pdf.

[68] Form CRS, Appendix C, *available at* https://www.sec.gov/rules/proposed/2018/34-83063-appendix-c.pdf.

[69] Form CRS, Appendix F, *available at* https://www.sec.gov/rules/proposed/2018/34-83063-appendix-f.pdf.

[70] Form CRS Release, *supra* note 27, at II.C.2.

[71] *Id.* at II.C.1.

[72] *Id.* at II.C.3.

amendments to the Advisers Act and the Exchange Act.[73]

- *Compliance*: Firms would need to prepare Form CRS and comply with related provisions within six months after the eventual effective date.[74]

Titling Restrictions for Broker/Dealers. The Form CRS Release asserts that terms such as "financial adviser" or "financial advisor" used widely by broker/dealers are similar enough to the monikers used by registered investment "advisers" that retail investors may reasonably confuse their broker/dealer with a full-service investment adviser (with or without noticing the spelling difference), despite the substantive differences between investment advisory and brokerage services.[75] The Form CRS Release would restrict the use of the terms "adviser" and "advisor" by broker/dealers except when using the terms on behalf of a bank, insurance company, municipal advisor, or commodity trading advisor.[76]

As noted at the April 2018 open meeting where the SEC Proposals were announced, concerns include that firms could potentially skirt the titling requirements by referring to themselves as, for example "retirement professionals," "investment professionals," or "financial consultants,"[77] and that a more concrete "holding out" standard could potentially run afoul of Section 202(a)(11)(C) of the Advisers Act, which allows broker/dealers to engage in advisory activities "solely incidental" to its services as a broker/dealer, as noted *supra*.[78]

C. The IA Release

The Proposed Fiduciary Duty Interpretation. The IA Release seeks to (i) summarize and restate investment advisers' fiduciary duties under the Advisers Act and (ii) generate input from the asset management industry on potential new requirements for investment advisers similar to those currently applicable to broker/dealers.[79] Like the Reg BI Release, the IA Release notes that the SEC did *not* propose a uniform standard of care for broker/dealers and investment advisers because of their disparate client relationships and business models;[80] the IA Release also poses a series of questions for commenters' consideration, discussed *infra*.

The interpretation proposed in the IA Release "reaffirms, and in some cases, clarifies" the current patchwork fiduciary standard[81] stemming largely from

[73] *Id.* at II.E.

[74] *Id.* at II.D.

[75] *Id.* at III.A.

[76] *Id.* at III.B.

[77] *See, e.g.*, Stein, *supra* note 25 (asserting that solely restricting broker/dealers' use of the terms "adviser" or "advisor," without more, could create such a "whack-a-mole" problem). *But see* Jackson, *supra* note 25 (commending the titling restrictions as a tentative step in the right direction).

[78] *See, e.g.*, Stein, *supra* note 25 (noting the potential issue with a more-interpretive "holding out" rule as it relates to the Advisers Act's broker/dealer exclusion).

[79] *See generally* IA Release, *supra* note 28.

[80] *Id.* at 5.

[81] The distinction between "fiduciary" and "best interest" standards underscores the arguably disparate expectations on conduct articulated for advisers under the IA Release and broker/dealers under Reg BI. In the Reg BI Release, the SEC staff explains that, though a *uniform fiduciary* standard was recommended in the 913 Study, further review of comments and SEC staff analysis of the differences between the two business models led the SEC to approve a Release non-uniform standard (that is not a "fiduciary" standard for broker/dealers). *See generally* Reg. In particular, the Reg BI Release notes that the SEC staff believes that a uniform fiduciary standard "is unlikely to provide a tailored solution to the conflicts that uniquely arise for either broker-dealers or investment advisers" and that "it is appropriate to maintain separate regulatory standards for broker-dealers and investment advisers, while proposing to incorporate and go beyond existing levels of retail customer protection for broker-dealer customers through Regulation Best Interest and Form CRS Relationship Summary Disclosure." *See id.* at 330-32. This is consistent with the Dodd-Frank Act, which *permits*, but does not *require*, the SEC to establish a uniform fiduciary standard for adviser and broker/dealers. *Compare* Dodd Frank Act, Section 913(g)(1) (amending Section 15 of the Exchange Act to state that "the Commission *may* promulgate rules [for retail customers such that] the standard of conduct for such broker or dealer with respect to such customer shall be *the same as* the [standard under Section 211 of the Advisers Act]") *with* Dodd-Frank Act, Section 913(g)(2) (amending the Advisers act to add that "[t]he Commission may promulgate rules to provide the standard of conduct for all brokers, dealers, and investment advisers [to retail customers, provided that] . . . . Such rules shall be *no less stringent* than the [current] standard applicable to investment advisers") (emphasis added). Therefore, the SEC need not pass a "uniform fiduciary standard," but rather need only impose a "standard of conduct" for broker/dealers that is "no less stringent" than that imposed upon investment advisers.

agency law and a few Supreme Court cases.[82] Using these guidelines, the IA Release outlines the two elements of advisers' fiduciary duty—the duties of care and loyalty.

> The duty of care encompasses the responsibility to provide advice that is in the client's "best interest," the obligation to seek "best execution,"[83] and the duty to proactively provide advice and monitoring over the course of the relationship.[84]
>
> The duty of loyalty requires putting clients' interests first and not "unfairly" favoring one client over another.[85]

The IA Release makes clear that advisers' fiduciary status requires them to disclose and attempt to mitigate conflicts of interest[86] by providing clients with sufficient facts under the circumstances[87] to make reasonably informed decisions before consenting to conflicts.[88] The IA Release also observes that: advisers must still act in their client's best interest even when they have made full and fair disclosure about their conflicts of interest;[89]

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The SEC Proposals purport to address the different regulatory regimes and business models of broker/dealers and investment advisers by imposing different obligations upon each, but without either obligation being less stringent than the other when factoring in the legal and factual differences between the two business models.

[82] For example, references to the Restatement (Third) of Agency permeate the IA Release, as do references to *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). Other citations are generally to SEC releases and to the Supreme Court cases *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), and *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), all of which generally cite back to *SEC v. Capital Gains* themselves. *See generally* IA Release, *supra* note 28.

[83] In this context, "best execution" requires seeking the most favorable transaction costs under the circumstances, with the SEC noting that "maximizing value can encompass more than just minimizing costs" and that "the determinative factor is not the lowest execution cost but whether the transaction represents the best qualitative execution." IA Release, *supra* note 28, at 13-14.

[84] The IA Release also suggests that advisers should consider clients' "best interest" over the course of the relationship, commensurate with the facts and circumstances surrounding the client relationship, which will likely change over time. IA Release, *supra* note 28, at 14-15.

[85] *Id.* at 9-15 & n.38 (citing Advisers Act Release No. 3060) ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own." (citing Advisers Act Release No. 2106)); *see also* 913 Study, *supra* note 32.

[86] IA Release, *supra* note 28, at 17–19 (discussing the duty to disclose conflicts and noting that, in some cases, "disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive . . . . In all of these cases where full and fair disclosure and informed consent is insufficient, we expect an adviser to eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed") (citing to, *inter alia*, *SEC v. Capital Gains*); *cf. id.* at 19 & n.49 ("As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and at a minimum, make full disclosure [of all such material conflicts]."); *see also* NEP Risk Alert, *OCIE's 2016 Share Class Initiative* (July 13, 2016) (noting in a discussion of impermissibly conflicted investment adviser mutual funds share class recommendation practices observed by OCIE staff that "as a fiduciary, an adviser has an obligation to act in its client's *best interest* and to disclose material conflicts of interest such as the receipt of compensation for selecting or recommending mutual fund share classes") (emphasis added) (citing Advisers Act Release No. 3686 (Oct. 2, 2013)).

[87] IA Release, *supra* note 28, at 17 ("An adviser must provide the client with sufficiently specific facts so that the client is able to understand the adviser's conflicts of interest and business practices well enough to make an informed decision."); s*ee also* NEP Risk Alert, *Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers* (Apr. 12, 2018) (discussing the requirement for advisers to make full, fair and accurate disclosure of adviser compensation arrangements (fees and expenses) that allows investors to make informed investment decisions). *See generally* IA Release, *supra* note 28, at 17–19 (discussing in detail the need for advisers to determine clients' fact-specific circumstances in disclosing and mitigating conflicts and noting that "a client's informed consent [to conflicts] can be either explicit or, depending on the facts and circumstances, implicit").

[88] IA Release, *supra* note 28, at 17 ("Disclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers Act. Any disclosure must be clear and detailed enough *for a client to make a reasonably informed decision to consent to such conflicts and practices or reject them*.") (emphasis added) (citing, *inter alia*, to *SEC v. Capital Gains*).

[89] *Id.* at 8 ("The duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship through contract when the client receives *full and fair disclosure* and provides informed consent.

advisers cannot "disclose or negotiate away, and investors cannot waive," the adviser's duty to place the client's interest ahead of its own;[90] and, without offering examples of relevant fact patterns, some conflicts may not be cured.[91]

Potential Adviser Licensing, Continuing Education, Client Communications, Net and Capital Requirements and Open Questions. Although the states may impose them, there are currently no licensing or qualification requirements for investment adviser representatives under the Advisers Act similar to those for broker/dealer representatives, and no fidelity bond or capital requirements under the Advisers Act similar to those for broker/dealers under the Exchange Act and FINRA requirements.[92] Similarly, there is no existing requirement under the Advisers Act that advisers provide account statements to all clients.[93] The SEC's request for comment on the fiduciary duty interpretation proposal included in the IA Release seeks industry input on whether such requirements should be applicable to investment advisers and their personnel, posing thematic questions including:

- Should investment adviser representatives be subject to continuing education requirements, how should such education requirements be structured, and what other types of advisory personnel should also be covered?[94] What type of licensing and certifications would be appropriate? For example, should individuals register with the SEC on a form similar to Form U4 (as required for broker/dealer representatives)?[95] With what frequency should education, licensing and recertification requirements be imposed?[96] To what extent would such requirements be duplicative of existing education and certification within the investment adviser industry?[97]

- Should the SEC require all advisers to provide clients with regular account statements?[98] To what extent do retail clients already receive regular account statements?[99] If clients are uncertain about what fees and expenses they will pay, would they benefit from an up-front written agreement specifying fees and expenses to be paid prior to receiving any investment advice from an adviser?[100] What types of costs would this entail, and what delivery methods could mitigate those costs?[101]

- Considering the extensive financial responsibility safeguards under the Exchange Act, including recordkeeping, asset segregation, and net capital requirements, should investment advisers be subject

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Although the ability to tailor the terms means that the application of the fiduciary duty will vary with the terms of the relationship, *the relationship in all cases remains that of a fiduciary to a client*.") (emphasis added).

[90] *Id.* at 8 and accompanying n.21 (citing RESTATEMENT (THIRD) OF AGENCY, and various SEC comment letters).

[91] *Id.* at n.21 and accompanying text ("Disclosure may, but will not always, cure the fraud, since a fiduciary owes a duty to deal fairly with clients," quoting TAMAR FRANKEL, ARTHUR LABY & ANN SCHWING, THE REGULATION OF MONEY MANAGERS (3d ed. 2017)). Some commenters have suggested that the SEC's assertion that some conflicts cannot be cured by disclosure is an unsupported extension of the ruling in *SEC v. Capital Gains.*

[92] *Id.* at n.81 ("Many states have imposed fidelity bonding and/or net capital requirements on state-registered investment advisers"). For a state-by-state reference of fidelity bond requirements and capital thresholds that exempt advisers from state fidelity bond requirements, see the North American Securities Administrators Association's *State Investment Adviser Registration Information* website, *available at* http://www.nasaa.org/industry-resources/investment-advisers/ia-switch-resources/state-investment-adviser-registration-information/ (last visited Aug. 30, 2018).

[93] *But see* Advisers Act Rule 206(4)-2(a)(3) (requiring quarterly client account statements to be delivered under certain circumstances) and Rule 3a-4 under the Investment Company Act of 1940 (the "Investment Company Act") (in broad terms, providing a non-exclusive safe harbor from the definition of an investment company and from registration under the Investment Company Act for certain advisory programs provided on a discretionary basis to a large number of advisory clients each investing a small amount, provided certain conditions are met, including the delivery of quarterly

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statements and quarterly client information requests by the adviser as described under Rule 3a-4(a)(2)(iii) and (a)(4)).

[94] IA Release, *supra* note 28, at 29 (noting that the 913 Study requested that the Commission study and consider whether such requirements were appropriate).

[95] *Id.* at 29.

[96] *Id.*

[97] *Id.*

[98] *Id.* at 32.

[99] *Id.* at 33.

[100] *Id.*

[101] *Id.*

to net capital requirements (and if so, in what amount), other financial responsibility requirements to clients, annual audits, or a requirement to maintain fidelity bonds?[102] Should some of the above requirements be disclosed in Form ADV?[103]

D. Comments on the SEC Proposals

The open comment period for the SEC Proposals ended on August 7, 2018. Hundreds of investors, investment professionals, legal professionals, and trade associations weighed in on the SEC Proposals, along with state securities regulators.[104] SEC Commissioners have also reportedly engaged in dozens of meetings with members of the asset management and legal industries.[105] The comments submitted range from harshly critical of the various elements of the SEC Proposals,[106] to constructively critical or supportive, and the spread of subjects raised by the comment letters underscores the diversity of issues and concerns that should be resolved prior to any finalization of the SEC Proposals.[107] A few of these letters, which are presented as representative examples, are summarized below, along with additional public comments on the SEC Proposals made by an SEC Commissioner.

New York City Bar. In its comment letter on the IA Release, the New York City Bar's Committee on Investment Management Regulation (the "NYC Investment Management Bar") expressed two primary issues "with respect to the disclosure of an investment adviser's potential or actual conflicts of interest."[108] First, the NYC Investment Management Bar argues that the IA Release surpasses established case law such as *SEC v. Capital Gains* by stating that disclosure of a conflict of interest may not always be enough for an investment adviser to satisfy its fiduciary duty.[109] Second, the NYC Investment Management Bar argues that the IA Release is unclear as to when and how a client can give "informed consent" to an investment adviser regarding a conflict of interest.[110]

Investment Adviser Association. The Investment Adviser Association (the "IAA") requests that the SEC publicly share the results of its investor testing on the efficacy of the proposed Form CRS in conjunction with an extension of the comment period.[111] According to the IAA, this would allow the ultimate Form CRS to be designed so that investors can be provided with "an accurate and balanced understanding of the information [Form CRS] is intended to convey."[112]

The IAA notes potential gaps in retail investor protection, calling the scope and application of Reg BI too narrow and recommending that all advisory activities a broker/dealer provides to a client should be covered by Reg BI or the Advisers Act fiduciary standard, and that the SEC should further define advice that is considered not to be "solely incidental" to brokerage activities and

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[102] *Id.* at 33-37. Citing such Exchange Act requirements as broker/dealers' membership with the Securities Investor Protection Corporation, which can protect a customer's brokerage account up to $500,000, including up to $250,000 in cash in an account, as well as FINRA rules requiring broker/dealers to obtain fidelity bonds, the IA Release seeks detailed input on what amounts of net capital and what levels of bonding would be appropriate for different types of advisers. *Id.*

[103] *Id.* at 37-38.

[104] *See, e.g.*, *infra* note 151 (regarding the comment letter on the SEC Proposals submitted by William F. Galvin, Secretary of the Commonwealth of Massachusetts).

[105] SEC, COMMENTS ON FORM CRS RELATIONSHIP SUMMARY; AMENDMENTS TO FORM ADV (last visited Aug. 30, 2018), https://www.sec.gov/comments/s7-08-18/s70818.htm (last visited Aug. 30, 2018); SEC, COMMENTS ON PROPOSED COMMISSION INTERPRETATION REGARDING STANDARD OF CONDUCT FOR INVESTMENT ADVISERS (last visited Aug. 30, 2018), https://www.sec.gov/comments/s7-09-18/s70918.htm; SEC, COMMENTS ON PROPOSED RULE: REGULATION BEST INTEREST (last visited Aug. 30, 2018), https://www.sec.gov/comments/s7-07-18/s70718.htm.

[106] *See, e.g.*, New York City Bar, Committee on Investment Management Regulation, Comment Letter on the IA Release (June 26, 2018), https://www.sec.gov/comments/s7-09-18/s70918-3937033-167034.pdf.

[107] *See, e.g.*, Charles Schwab & Co., Inc., Comment Letter on the SEC Proposals (Aug. 6, 2018), *available at*:

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https://www.sec.gov/comments/s7-08-18/s70818-4171281-172183.pdf.

[108] *Id.*

[109] *Id.*

[110] *Id.*

[111] IAA, Comment Letter on SEC Proposals (May 25, 2018), https://www.sec.gov/comments/s7-09-18/s70918-3713511-162482.pdf [hereinafter May IAA Letter].

[112] *Id.*

perhaps revisit this exclusion under the Advisers Act.[113] It also suggests that the SEC should provide on its website the comparative information about broker/dealers that the SEC Proposals would require in Form CRS under certain circumstances, and that Form CRS be otherwise streamlined.[114] The IAA argues that the proposed titling restrictions for broker/dealers included in the SEC Proposals will have limited impact and that the SEC might be better served by focusing on broker/dealer marketing practices.[115] And, the IAA asserts that it is not "is necessary or beneficial to codify" advisers' existing fiduciary duties and that the SEC's potential application of net capital and similar requirements to advisers would be "inapt . . . [,] would not effectively address the [SEC]'s concerns, and [would be] unnecessarily duplicative or burdensome…." The IAA recommends that the SEC instead focus on "raising the standard of conduct for brokers to match investors' expectations regarding the advice they receive."[116]

Investment Company Institute. In its comments on the SEC Proposals, the Investment Company Institute (the "ICI") "encourage[s] the SEC to continue to coordinate closely with DOL so that DOL explicitly recognizes the SEC's best interest standard of conduct (once adopted in final form) in a new, streamlined prohibited transaction exemption for financial professionals that are subject to an SEC-governed standard of conduct."[117] The ICI urges the SEC, in any final Reg BI, "to explicitly affirm," consistent with Section 15(i) of the Exchange Act and Section 203A of the Advisers Act, "that SEC standards of conduct would preempt any standards under state law that are inconsistent with SEC regulation."

Focusing on the potential impact of the SEC Proposals on mutual funds, exchange-traded funds, and closed-end funds, the ICI also provides significant comments and background information, the details of which are outside the scope of this article, but which the ICI summarizes as input on:

- "The scope of a broker-dealer's obligation to disclose and consider fund fees" and a recommendation "that the SEC confirm that it would permit a broker-dealer to direct customers to the fund prospectus for detailed, standardized information about fund fees and expenses, and would not require a broker-dealer to separately calculate fund-level fees and expenses, provide personalized fee disclosure at the outset of the customer relationship, or consider only costs to the exclusion of other relevant factors in making recommendations."[118]

- Statements in the SEC Proposals "that are likely to discourage broker-dealers from recommending proprietary products or a limited range of products, when such a recommendation may be in the customer's best interest."[119]

- The proposed definitions of "retail investor/customer" for purposes of proposed Reg BI and Form CRS, and a recommendation "that the SEC adopt a single definition of 'retail investor' for purposes of both rulemakings, limited to natural persons." [120]

- "The SEC's proposed interpretation of an investment adviser's fiduciary duty," and a recommendation that the SEC refine the proposed interpretation "so that it is more consistent with existing law regarding an adviser's fiduciary duty. Specifically . . . the SEC [should]: (i) acknowledge that institutional advisory relationships may differ in important ways from retail advisory relationships, which are the focus of the proposed interpretation; and (ii) confirm that the standard for client consent under the Advisers Act is whether the adviser has provided full and fair disclosure of material conflicts and obtained informed client consent."[121]

[113] IAA, Comment Letter on the SEC Proposals (Aug. 6, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4171283-172164.pdf.

[114] *Id.*

[115] *Id.*

[116] IAA, Comment Letter on the IA Release (Aug. 2, 2018), https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/IAA_Comment_Letter_to_SEC_re_Request_for_Comment_on_Additional_Adviser_Regulation_8-2-18_v.pdf.

[117] ICI, Comment Letter on SEC Proposals (Aug. 7, 2018), https://www.ici.org/pdf/18_regulation_best_interest_ltr.pdf [hereinafter "ICI Comment Letter"].

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.*

- The potential incorporation, set forth in the IA Release, of "certain broker-dealer rules into the investment adviser regulatory framework" and the recommendation that "the SEC not pursue these changes . . . [as] the SEC has neither articulated why these potential changes would be beneficial, nor has it addressed key concerns and questions they raise."[122]

American Bar Association. The Hedge Funds Subcommittee of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association ("ABA Subcommittee") submitted a comment letter with four key criticisms and recommendations for the IA Release.[123] First, the ABA Subcommittee suggests that the SEC consider "revising the discussion of an investment adviser's fiduciary duty to recognize that the content of this duty must be viewed in the context of the particular relationship between and investment adviser and its client."[124] Second, the ABA Subcommittee suggests that the IA Release be modified to reflect that the federal fiduciary duty cannot be waived with a blanket waiver that is not full and fair to the client.[125] Third, the ABA Subcommittee suggests that the IA Release be modified to acknowledge that sophisticated investors are deemed to have given informed consent upon the receipt of full and fair disclosure.[126] Finally, the ABA Subcommittee suggests that any final rulemaking should reflect that an investment adviser can receive informed consent from a client through full and fair disclosure, and "only if informed consent is unavailable must an investment adviser avoid the conflict of interest."[127]

SEC Commissioners. As noted *supra*, SEC Commissioners have taken an active role in critiquing the SEC Proposals. In a July 24, 2018 speech, Commissioner Hester M. Peirce discussed her concerns with Reg BI and the IA Release.[128] Specifically, Commissioner Pierce said she believed that the terms "best interest" and "fiduciary" have become convoluted, both in nomenclature and in the investing public's understanding. She argued that it could be more instructive to avoid the term "best interest" altogether "because nobody can explain what it means,"[129] and said she would prefer a simplified two-factor standard that (i) is focused on the "suitability" of investment advice instead of the "best interest" of the client, and (ii) prevents broker/dealers from putting their own interests ahead of their retail customers.[130]

III. THE STATES SPEAK ON FIDUCIARY INVESTMENT ADVICE

As the DOL and SEC processes developed, the states also acted in ways that variously overlapped with, complemented, and contradicted parts of the DOL Fiduciary Rule and even the SEC Proposals. Now that the Fifth Circuit ruling has become final, the status of these state legislative and enforcement actions is more significant: they could change rapidly as state regulators respond to developments at the federal level, and they could also become more significant in protecting investors during this period of uncertainty. The question of whether the SEC intends to preempt state law with the SEC Proposals is unsettled, particularly given the June 21, 2018 remarks of Chairman Clayton indicating his potential willingness to cooperate with state securities agencies in regulating the activities of advisers and broker/dealers while striking an appropriate balance of federalism.[131]

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[122] *Id.*

[123] ABA Subcommittee, Comment Letter on IA Release (Aug. 24, 2018), https://www.sec.gov/comments/s7-09-18/s70918-4260675-173078.pdf.

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] *Id.*

[128] Hester M. Peirce, Comm'n, Sec. & Exch. Comm'n, Public Speech, *What's in a Name? Regulation Best Interest v. Fiduciary*, National Association of Plan Advisors D.C. Fly-In

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Forum, Washington, D.C. (July 24, 2018), *available at* https://www.sec.gov/news/speech/speech-peirce-072418.

[129] *Id.* at n.32 and accompanying text.

[130] *Id.* at Part IV (explaining that the "suitability" standard is already well-established within the financial community, unlike a "best interest" standard).

[131] Oversight of the U.S. Securities and Exchange Commission: Before the *H. Comm. on Fin. Serv.*, 115th Cong. (June 21, 2018) (statement of Jay Clayton, Chairman, Sec. & Exch. Comm'n) (discussing recent nationwide roundtable discussions with retail investors in the context of the standards of conduct for broker/dealers and investment advisers and noting that "[t]hese interactions, including consultations with my fellow Commissioners and staff, led me to the conclusion that the Commission should lead — **but not dictate** — our federal and state regulatory efforts in this area in order to (1) address investor confusion regarding the roles of, and the differences between, broker-dealers and investment advisers;

Multiple States. On June 7, 2017, the Treasurers of 13 states delivered a letter to the DOL stressing that: (i) "the retirement savings crisis is growing daily;" (ii) the DOL Fiduciary Rule should not be amended in any way; and (iii) no basis existed to further delay the Rule.[132]

Nevada. On July 1, 2017, the Nevada Senate adopted a bill (i) requiring all investment advisers, broker/dealers and sales representatives to adhere to a fiduciary standard when engaging with retirement and non-retirement investors in Nevada; (ii) requiring firms to make conflicts of interest disclosures and to be informed of customers' financial circumstances and goals; and (iii) establishing a right of civil action for economic losses arising from a firm's gross negligence or breach of fiduciary duty in making investment-related recommendations.[133] The Nevada Secretary of State announced that its Securities Division was in the process of drafting regulations to comply with the Senate bill on September 8, 2017.[134]

New York. Similarly, in December 2017, the Governor of New York announced that the New York Department of Financial Services was proposing to extend its existing suitability regulations to sellers of life insurance and annuity products.[135] The proposed amendments would apply to all sales of life insurance and annuity products,

> beyond the types of advice covered by the DOL [Fiduciary Rule], including both in the specific context of retirement planning and when recommendations are made prior to the sale of an insurance product or after the sale but during the servicing of the product for the consumer. A transaction [would be] considered in the best interest of a consumer when it is in furtherance of a consumer's needs and objectives and is recommended to the consumer without regard to the financial interest of the product seller. Insurers would also be required to develop and maintain procedures to prevent financial exploitation of consumers.[136]

On April 27, 2018, after the announcement of the SEC Proposals, the New York Department of Financial Services made amendments to the text of the amendments proposed in December 2017, though the "best interest" language remains a staple of the revised regulation and the press release.[137] Securities regulators in New York and Massachusetts (discussed *infra*), which are home to countless asset management firms, seem to

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(2) establish standards of conduct that meet reasonable investor expectations and adequately address conflicts of interest; and (3) minimize the effects of regulatory complexity, and potentially inconsistent legal standards applied to financial advice, due to the number of regulators in this space" (emphasis added)), *available at*: https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission#_ftnref21; *see also* ICI Comment Letter, *supra* note 117 ("Even in the absence of the DOL fiduciary rule, however, the potential for inconsistent and confusing standards of conduct remains. Specifically, recent activity at the state level again has raised the specter of multiple and differing standards of conduct (or related disclosure requirements), which could result in inconsistent protections for investors and a patchwork of confusing and burdensome requirements for firms with business in multiple states.").

[132] Letter from the State Treasurers of Pennsylvania, Oregon, Iowa, Louisiana, Maryland, South Carolina, Rhode Island, Utah, Vermont, Washington State, Illinois, Wyoming, and Massachusetts to Alexander Acosta, Secretary of Labor, re: *Conflict of Interest Rule – Retirement Investment Advice* (RIN 1210-AB79) 81 Fed. Reg. 21,002 (Apr. 16, 2016), (June 7, 2017).

[133] Nevada Legislature, S.B. 383.

[134] NEVADA SECRETARY OF STATE, NEW! FIDUCIARY DUTY - SB 383 (last updated Oct. 3, 2017), http://nvsos.gov/sos/licensing/securities/new-fiduciary-duty.

[135] Press Release, New York Dep't of Financial Services, Governor Cuomo Announces New Consumer Protections for Life Insurance Sales- Proposed DFS Regulation Would Require that Life Insurance and Annuity Sales Meet a "Best Interest" Standard that Protects Consumers from Unnecessarily High Costs and Conflicted Financial Advice - Protections Proposed as Washington Continues Delay on National Reforms (Dec. 27, 2017), *available at* http://www.dfs.ny.gov/about/press/pr1712271.htm.

[136] *Id.*

[137] Press Release, New York Dep't of Financial Services, DFS Issues Updated Proposed Life Insurance and Annuity Suitability Regulation Requiring a Best Interest Standard to Protect Consumers from Conflicted Advice: Proposed Rule Aims to Ensure That Recommendations Related to Life Insurance and Annuities Are in Consumers' Best Interest (Apr. 27, 2018), *available at* https://www.dfs.ny.gov/about/press/pr1804271.htm.

be paying close attention to what is happening at the federal level and recalibrating quickly in response.

New Jersey. On January 9, 2018, the New Jersey Senate and General Assembly re-introduced a bill that would, among other things, require any "non-fiduciary investment advisor" to disclose, both verbally and in writing, prior to engaging a client or giving them advertising materials, that the advisor did not have to act in the client's best interests; specifically stating:

> I am not a fiduciary. Therefore, I am not required to act in your best interests and am allowed to recommend investments that may earn higher fees for me or my firm, even if those investments may not have the best combination of fees, risks, and expected returns for you.[138]

Then in September 2018, "on the ten-year anniversary of the 2008 global financial crisis," the Governor of New Jersey announced plans at the New Jersey Bureau of Securities to adopt a "uniform fiduciary standard" for all "New Jersey investment professionals requiring them to put their clients' interests above their own when recommending investments" that would go beyond the SEC Proposals.[139]

Maryland. On February 7 and February 9, 2018, respectively, the Maryland House and Senate introduced bills containing language that would require broker/dealers to act as fiduciaries primarily for the benefit of their clients and require investment advisers and other fiduciaries to disclose to clients their potential profit or commission and any legal or disciplinary events "material to the [fiduciary's] integrity."[140]

The final bill adopted in Maryland, the Financial Consumer Protection Act of 2018,[141] struck the fiduciary requirements of the initial bills shortly after the SEC Proposals were released. Approved by the Maryland legislature and Governor on May 15, 2018, the updated bill requires the Maryland Financial Consumer Protection Commission to study, among other issues, the DOL Fiduciary Rule and any SEC final rules addressing conflicts of interest of broker/dealers offering investment advice by aligning the standards of care, and potential changes to state law to provide the protection intended by the Rule. In this sense, Maryland is proposing a wait-and-see approach similar to that espoused by the Dodd-Frank Act, which authorized a study of developing federal law and permitted state regulators to jump in to fill the gaps after the dust settled.

Massachusetts. Also in February 2018, the Massachusetts Securities Division announced that it was seeking public comment on a proposed rule that would require state-registered investment advisers to disclose all fees charged to clients, including any charged by third parties.[142] A week later, on February 15, 2018, the Massachusetts Securities Division's Enforcement Section ("Massachusetts Enforcement") filed an administrative complaint against a Massachusetts-registered broker/dealer (Scottrade) alleging violations of the Massachusetts Uniform Securities Act[143] and seeking to impose administrative sanctions.[144] The action was publicized on the commonwealth website as an attempt to enforce the DOL Fiduciary Rule in the

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[138] Senate No. 735, State of New Jersey, S.B. 735/A. 335. In retrospect, the language "I am not a fiduciary[, t]herefore I am not required to act in your best interests" is somewhat ironic (and could raise federal preemption issues) in the context of the SEC Proposals, where the fiduciary duty of investment advisers is reaffirmed with reference to clients' "best interest," but the standard under proposed Reg BI, as noted on pages 328-332 of the Reg BI Release, in based on the SEC's consideration and ultimately dismissal of suggestions to hold broker/dealers to a "fiduciary" standard. The same language, through the lens of Reg BI, therefore, would read "I am not a fiduciary, *however*, I *am* required to act in your 'best interest.'"

[139] Press Release, State of New Jersey, Governor Phil Murphy, Governor Murphy Marks 10 Year Anniversary of 2008 Financial Crisis by Announcing Plan to Require NJ Financial Industry to Put Customers' Interests First (Sept. 17, 2018) (stating that "in May 2018, the SEC proposed a rule that purportedly would require broker-dealers to act in their clients' "best interest"… [that] would be a higher standard of conduct than the current suitability standard required for broker-dealers, but would still fall short of protecting investors as much as a uniform fiduciary standard would"), *available at* https://nj.gov/governor/news/news/562018/approved/20180917c.shtml.

[140] General Assembly of Maryland, H.B. 1634; S.B. 1068.

[141] Ch. 732 (May 15, 2018); *see* General Assembly of Maryland, Financial Consumer Protection Act of 2018.

[142] Massachusetts Securities Division, *Preliminary Request for Public Comment on Proposed Fee Table for State-Registered Investment Advisers* (Feb. 7, 2018), *available at* https://www.sec.state.ma.us/sct/sctfeetable/feetableidx.htm.

[143] Mass. Gen. Laws. ch. 110A.

[144] *In the Matter of Scottrade, Inc*. (Feb. 15, 2018), *available at* https://www.sec.state.ma.us/sct/current/sctscottrade/scottradeidx.htm [hereinafter "Scottrade Complaint"].

absence of federal enforcement. The complaint extensively discusses the Rule and alleges that the broker/dealer "knowingly violated its own internal policies and procedures designed to ensure compliance with [the Rule]." The Massachusetts Uniform Securities Act is relatively broad in scope and imposes direct fiduciary duties on investment advisers and broker/dealers alike outside of the retirement setting[145]—leaving open the possibility that, absent prompt SEC action, Massachusetts Enforcement may seek to use its authority to reach beyond the retirement space and enforce stricter duties on broker/dealers generally.

With this stage set, on June 25, 2018 Massachusetts Enforcement filed another administrative action against an insurance and annuity provider (MetLife),[146] alleging that its failure to properly allocate retiree benefits from pension risk transfers to retirees violated the Massachusetts Uniform Securities Act and certain regulations thereunder.[147] Though the investigation is ongoing, Massachusetts Enforcement has alleged, inter alia, that the respondent made materially misleading statements in its public filings,[148] negligently failed to pay retirees,[149] and used retirement reserves for its own benefit.[150] Massachusetts Enforcement has requested censure and a fine as well as reimbursement with interest for all Massachusetts residents eligible for such benefits.

The Secretary of the Commonwealth of Massachusetts submitted a comment letter on the SEC Proposals in his "capacity as the chief securities regulator for Massachusetts" and made the following statement:

> I urge the Commission to replace the current [SEC] Proposals with a strong uniform fiduciary standard, comparable to the standard applicable under the . . . Advisers Act . . . , that will apply to advice provided to retail investors by both investment advisers and broker-dealers. If the [SEC] does not adopt a strong and uniform fiduciary standard, Massachusetts will be forced to adopt its own fiduciary standard to protect our citizens from conflicted advice by broker-dealers.[151]

IV. LOOKING FORWARD

Much is in flux in the asset management industry. Long-standing norms have been upset relatively overnight, and the priorities of state and federal regulators can feel as uncertain as the current political dynamics in Washington, D.C.

Asset management firms should of course make every effort to remain informed of the regulatory developments affecting their businesses and compliance programs. They might begin analyzing the extent of the changes, if any, they would need to make if the SEC Proposals were adopted as released. And they might also begin proactively identifying and mitigating any unaddressed, unique conflicts of interest related to the businesses they conduct. Firms should be sure that they are compliant with any already-effective, applicable state laws and should understand what would be required to comply with any applicable state legislation hanging in the balance. Firms in states with securities regulators oriented like those in New Jersey, New York, and Massachusetts should be particularly focused on state law developments. What may prove the harder task is waiting to see what, if any, next steps the DOL, the SEC, and the states may take. ■

[145] *See id.* at VII; Mass. Gen. Laws. ch. 110A, § 204.

[146] *In the Matter of MetLife, Inc.* (June 25, 2018), *available at* http://www.sec.state.ma.us/sct/current/sctmetlife/MetLife-Complaint-E-2017-0119.pdf [hereinafter "MetLife Complaint"].

[147] Mass. Gen. Laws. ch. 110A; *see also* Mass. Code Regs. 10.00–14.413.

[148] MetLife Complaint, *supra* note 146, at I.

[149] *Id.* at VII.B.

[150] Id. at VII.C.

[151] *See* Comment Letter from the Secretary of the Commonwealth of Massachusetts (Aug. 7, 2018), *available at* http://www.sec.state.ma.us/sct/sctpdf/SECCommissioners.pdf.

CLE QUESTIONS on Williamson, Williams, and Ahmadifar, *Developments in the Regulation of Fiduciary Investment Advice.* Circle the correct answer to each of the questions below. If at least four questions are answered correctly, there is one credit for New York lawyers (nontransitional) for this article. Complete the affirmation, evaluation, and type of credit, and return it by e-mail attachment to rscrpubs@yahoo.com. The cost is $40, which will be billed to your firm. To request financial aid, contact us by e-mail or fax, as provided above.

1. On March 15, 2018, the Fifth Circuit Court of Appeals vacated the DOL Fiduciary Rule in its entirety and the DOL did not appeal the decision to the Supreme Court. **True** **False**

2. Proposed Regulation BI would establish the obligation of broker/dealers to act in the best interest of retail customers without placing the financial interest of the broker/dealer ahead of the interest of the customer. **True** **False**

3. The SEC staff believes that the Dodd-Frank Act requires the SEC to establish a "uniform fiduciary standard" for broker/dealers and investment advisers. **True** **False**

4. Among the many comments received by the SEC on its proposals, a New York Bar committee objected that the IA Release surpasses established case law by stating that disclosure of a conflict of interest and obtaining customer consent may not always be enough for an investment adviser to satisfy its fiduciary duty. **True** **False**

5. On April 27, 2018, after the announcement of the SEC proposals, the New York Department of Financial Services announced amendments to its proposed best interest standard for sales and servicing of insurance products and annuities. **True** **False**

A F F I R M A T I O N

_____, Esq., an attorney at law, affirms pursuant to CPLR
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2106 and under penalty of perjury that I have read the above article and have answered the above questions without the assistance of any person.

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