

Alert | Financial Regulatory & Compliance



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SEC Approves Final Regulation Best Interest, Form CRS

On June 5, 2019, the Securities and Exchange Commission (SEC) **voted** 3-1 to adopt a series of proposals intended to “substantially enhance” the standards of conduct for financial professionals.

First and foremost, the SEC adopted Regulation Best Interest (Reg BI), a new rule establishing an updated standard of conduct for broker-dealers and associated persons of broker-dealers when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. The standard of conduct – which is higher than the current suitability requirement, but falls short of a fiduciary standard – is “to act in the best interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interest of the retail customer.” Notably, the SEC does not define “best interest,” an omission criticized by SEC member Robert Jackson Jr., the lone dissenter from approval of the rule package because he has supported adoption of a stricter standard.

The commissioners also adopted Form CRS, which are new rules requiring registered investment advisers and registered broker-dealers to provide a brief relationship summary to retail investors. According to a fact sheet distributed the June 5 meeting, the relationship summary must be delivered by brokers and advisers at the beginning of a relationship, and must summarize services, fees and costs, conflicts of interest, legal standard of conduct, and whether a firm or its representatives have a disciplinary history.

The relationship summary will also have a standardized Q&A format to promote comparison by retail investors.

In conjunction with its adoption of the new rulemaking package, the commissioners issued two separate interpretations under the Investment Advisers Act of 1940. The first is an interpretation reaffirming and clarifying certain aspects of the standard of conduct for registered investment advisers, who already owe a federal fiduciary duty to their clients. SEC Chairman Jay Clayton indicated that the interpretation “reflects how the Commission and its staff have applied and enforced the law in this area, and inspected for compliance, for decades.”

The second is an interpretation of the “solely incidental” prong of section 202(a)(11)(C) of the Investment Advisers Act, which exempts brokers from having to register as advisers if they give advice that is solely incidental to the conduct of his or her business as a broker or dealer, and for which they receive no special compensation. The final interpretation confirms and clarifies the commission’s position, and illustrates the application in practice in connection with exercising investment discretion over customer accounts and account monitoring.

In his opening remarks, Chairman Clayton emphasized that the rule package purposely maintains separate regulations for brokers, who must adhere to Reg BI, and advisers, who will continue to meet a fiduciary standard. In rejecting the idea of a uniform standard, he noted “[a] one-size-fits-all approach . . . presents significant risks,” and could lead to a restriction in advice business models.

One question left unanswered today is whether state fiduciary standards, such as those developed by Nevada and New Jersey, would be preempted by the SEC’s rule. On this point, Commissioner Jackson said, “I am deeply discouraged that our release is unclear about whether, and how, today’s rule will displace carefully constructed and hard-won state laws . . . We can and should say unequivocally that today’s release sets a federal floor, not a ceiling, for investor protection. Our failure to do so invites extensive and expensive litigation over the scope of the rule – and its effects on nascent state regulation.”

It has been widely reported that the U.S. Department of Labor (DOL) is working with the SEC to adopt the same standards as Reg BI for retirement product advisers, whether regulated by the SEC or not, and a new DOL fiduciary rule proposal is anticipated later this year.

The new Reg BI and Form CRS rules will go into effect 60 days after they are published in the Federal Register, but firms will have until June 30, 2020, to comply. The Investment Advisers Act interpretations will take effect as soon as they are published. This is a continuing process. Check back with GT as we report further developments and provide a more detailed analysis.

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