

MEMO# 31174

April 19, 2018

SEC Releases Proposals on Standards of Conduct for Broker-Dealers and Investment Advisers

[31174]

April 19, 2018 TO: ICI Members

Investment Company Directors SUBJECTS: Compliance

Disclosure

Distribution

Fees and Expenses

Intermediary Oversight

Investment Advisers

Operations

Pension

Transfer Agency RE: SEC Releases Proposals on Standards of Conduct for Broker-Dealers and Investment Advisers

The SEC voted 4-1 on Wednesday to propose a package of rulemakings and interpretations designed to enhance the quality and transparency of investors' relationships with investment advisers and broker-dealers, while preserving access to a variety of types of advice relationships and investment products.[\[1\]](#) The Proposals are described briefly below. We will send out a more detailed memorandum soon.

ICI will be submitting a comment letter on the Proposals, which will be due to the SEC 90 days following publication of the Proposals in the *Federal Register*.[\[2\]](#)

1. Regulation Best Interest (BI)

Under proposed Regulation Best Interest, a broker-dealer making a recommendation to a retail customer would have a duty to act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interest of the retail customer.

A broker-dealer would discharge this duty by complying with each of three specific obligations:

- Disclosure obligation: At or before the time of the recommendation, disclose to the retail customer, in writing, the key facts about the relationship, including material conflicts of interest.

- Care obligation: Exercise reasonable diligence, care, skill, and prudence, to (i) understand the product; (ii) have a reasonable basis to believe that the product is in the retail customer's best interest; and (iii) have a reasonable basis to believe that a series of transactions is in the retail customer's best interest.
- Conflict of interest obligation:
 - Establish, maintain, and enforce policies and procedures reasonably designed to identify and then at a minimum to disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives;
 - Other material conflicts of interest must be at least disclosed.

2. Investment Adviser Interpretation

The Commission separately proposed an interpretation to reaffirm and, in some cases, clarify the Commission's views of the fiduciary duty that investment advisers owe to their clients. According to the Commission, by highlighting principles relevant to the fiduciary duty, investment advisers and their clients would have greater clarity about advisers' legal obligations.

The Commission also is requesting comment on: licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC-registered investment advisers, including fidelity bonds.

3. Form CRS - Customer Relationship Summary

The Commission also proposed to require investment advisers and broker-dealers, and their respective associated persons, to provide retail investors with a relationship summary. This standardized, short-form (4-page maximum) disclosure would highlight key differences in the principal types of services offered, the legal standards of conduct that apply to each, the fees a customer might pay, and certain conflicts of interest that may exist.[\[3\]](#) Form CRS would supplement other more detailed disclosures. For advisers, additional information can be found in Form ADV. For broker-dealers, disclosures of the material facts relating to the scope and terms of the relationship would be required under Regulation Best Interest.

Under the Proposal, certain broker-dealers, and their associated persons, would be restricted from using, as part of their name or title, the terms "adviser" and "advisor" — which are similar to "investment adviser." This aspect of the Proposal addresses the Commission's concern that the use of these titles may mislead retail customers into believing their firm or professional is a registered investment adviser.

Dorothy M. Donohue
Deputy General Counsel - Securities Regulation

Sarah A. Bessin
Associate General Counsel

Linda M. French
Assistant General Counsel

endnotes

[1] Commissioner Stein voted against issuing the Proposals. The three proposals can be found on the SEC's website at <https://www.sec.gov/rules/proposed.shtml> ("Proposal(s)"). Statements by Chairman Clayton, Commissioner Stein, and Commissioner Piwowar also can be found on the SEC's website at <https://www.sec.gov/news/statements>.

[2] In response to Chairman Clayton's June 2017 request for comment on standards of conduct for investment advisers and broker-dealers, ICI submitted two letters to the Commission related to the Proposals. The comment letters can be found at <https://www.sec.gov/comments/ia-bd-conduct-standards/iabdconductstandards.htm>.

[3] The Commission's Office of the Investor Advocate plans on conducting investor testing related to Form CRS.

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