

# KIRKLAND ALERT

April 27, 2018

## SEC Proposes Broker-Dealer Standards of Conduct and Related Investment Adviser Rulemaking and Guidance

On April 18, 2018, the Securities and Exchange Commission (“SEC”) proposed a long-anticipated package of rulemakings and interpretations aimed at establishing a broker-dealer standard of conduct and clarifying investor confusion about differences in a customer relationship with a broker-dealer and investment adviser. The proposals aim to develop a framework in which retail investors benefit from increased transparency and investor protection through the application of a number of consistent principles to both broker-dealers and investment advisers regarding disclosure, due care and conflicts of interest.

### *Standard of Conduct for Broker-Dealers*

Proposed “Regulation Best Interest” would establish a standard of conduct for a broker-dealer (and its licensed personnel) when recommending any securities transaction or investment strategy involving securities to a retail customer.<sup>1</sup> The standard of conduct requires a broker-dealer to act in the best interests of its retail customer, without placing the financial or other interests of the broker-dealer (or its licensed personnel) ahead of the interest of the retail customer, and provides that a broker-dealer could satisfy the standard by satisfying three obligations before or at the time of each recommendation:

- **Disclosure** – The broker-dealer must reasonably disclose material facts regarding the scope and terms of the relationship and material conflicts of interest to the retail customer in writing.
- **Care** – The broker-dealer must exercise reasonable diligence, care, skill and prudence when making the recommendation.
- **Conflicts of Interest** – 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 associated with the recommendation. Any material conflicts of interest arising from financial incentives associated with the recommendation must also be mitigated (if not eliminated).

### *Form CRS Relationship Summary; Amendments to Form ADV*

The SEC proposed Form CRS, a short-form client relationship summary aimed at reducing retail investor confusion, which would require a registered broker-dealer

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and investment adviser to provide retail investors<sup>2</sup> with disclosures regarding relationships and services offered by the firm, the firm's applicable standard of conduct, associated fees and costs, certain conflicts of interest, and any reportable legal or disciplinary events associated with the firm and its professionals. With respect to investment advisers, Form ADV would be amended to include new Part 3: Form CRS.

### *Restrictions on the Use of Certain Names or Titles*

The SEC also proposed new rules designed to reduce investor confusion. These rules would (i) restrict broker-dealers (and licensed personnel) from using the term “adviser” or “advisor” in certain communications with retail investors and (ii) require a broker-dealer and investment adviser (and associated natural and supervised persons) to disclose the firm's registration status with the SEC and the individual's relationship with the firm in its communications with retail investors.

### *Standard of Conduct Interpretation for Investment Advisers*

Finally, the SEC proposed an interpretation of the standard of conduct for investment advisers intended to codify and reaffirm (and, in some cases, clarify) the fiduciary duty that investment advisers owe to their clients, in order to provide greater transparency to investors regarding these obligations. The proposal highlights certain aspects of an investment adviser's fiduciary duty — specifically, the duty of care, which includes (i) the duty to provide advice that is in the client's best interest, (ii) the duty to seek best execution and (iii) the duty to act and to provide advice and monitoring over the course of the relationship, and the duty of loyalty.

### *Enhanced Investment Adviser Regulation*

This proposal also seeks comment regarding whether the SEC should propose requirements for investment advisers requiring licensing and continuing education requirements for an adviser's personnel, delivery of account statements to clients, including information about fees and expenses, and net capital/financial responsibility.

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The Commission is seeking public comment on each of these proposals.

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<sup>1</sup> A retail customer is a person, or the legal representative of a person (e.g., a trust) who (1) receives a recommendation of any securities transaction or investment strategy from the broker-dealer (and its licensed personnel) and (2) uses the recommendation primarily for personal, family or household purposes.

<sup>2</sup> A retail investor is a customer or potential customer who is a natural person (an individual) and a trust or other similar entity that represents natural persons even if another person is a trustee or managing agent of the trust.

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