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SEC Proposes Standard of Conduct for Broker-Dealers and Interpretation Regarding Standard of Conduct for Investment Advisers

SEC Approves Package of Proposed Rules and Interpretations Designed to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals

EXECUTIVE SUMMARY

On April 18, 2018, the Securities and Exchange Commission ("SEC") voted 4 to 1 (Commissioner Stein dissenting) to approve a package of proposed rules and interpretations with the stated goal of improving "the quality and transparency of investors' relationships with investment advisers and broker-dealers while preserving investor access to a variety of advice relationships and investment products."[1]

The approximately 1,000-page package comprises three separate proposals:

> (1) a proposed rule under the Securities Exchange Act of 1934 ("Exchange Act") establishing a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer ("Regulation Best Interest");[2]
>
> (2) a proposed interpretation regarding the standard of conduct for investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act");[3] and
>
> (3) proposed new and amended rules under the Advisers Act and the Exchange Act that, among other things, require registered investment advisers and registered broker-dealers to provide a brief relationship summary to retail investors in a mandatory disclosure form ("Form CRS") that summarizes key aspects of the relationship between such firms and their clients.[4]

Regulation Best Interest: Proposed Regulation Best Interest would require a broker-dealer, or a natural person who is an associated person of a broker-dealer, to act in the best interest of a "retail customer" when making a recommendation of any securities transaction or investment strategy involving securities,

without placing the financial or other interest of the broker, dealer or natural person who is an associated person of a broker-dealer making the recommendation ahead of the interest of the retail customer. "Retail customer" is defined as a person (or its legal representative) who uses such a recommendation primarily for personal, family or household purposes. This "best interest" standard would be satisfied through compliance with certain disclosure, care, and conflict of interest mitigation obligations. The proposed rule would apply in addition to any other obligations under the Exchange Act and any other applicable provisions of the federal securities laws and related rules and regulations.

Standard of Conduct for Investment Advisers: The SEC's proposed interpretation of the federal fiduciary standard applicable to investment advisers under Section 206 of the Advisers Act covers the scope and nature of an investment adviser's duties of care and loyalty. The Investment Advisers Release states that the SEC believes that its interpretation is generally consistent with advisers' current understanding of the practices necessary to comply with their fiduciary duty under the Advisers Act. In addition, the SEC has requested comment on whether it should impose additional legal obligations on investment advisers in a manner similar to those applicable to broker-dealers with respect to federal licensing and continuing education, provision of account statements and financial responsibility requirements.

Form CRS Relationship Summary and Related Proposals: The SEC's proposed rule relating to Form CRS requires broker-dealers and investment advisers to deliver the customer relationship summary to retail investors at the beginning of a relationship and upon any material change in the relationship. Form CRS would set forth, among other things, information about the relationships and services a firm provides to retail investors, the applicable standard of conduct, fees and costs, the differences between brokerage and advisory services, and conflicts of interest (much of which would be language prescribed by the SEC). The SEC intends that Form CRS will supplement other more detailed disclosure and reporting requirements already required by the securities laws and related rules and regulations. This release also proposed new rules aimed at reducing investor confusion between investment adviser and broker-dealer services. Specifically, the proposed new rule would restrict broker-dealers and their financial professionals from using the terms "adviser" or "advisor" as part of their name or title and would require investment advisers and broker-dealers to disclose their registration status with the SEC in all written and electronic retail investor communications.

Commissioner Reactions: At the open meeting held on April 18, 2018, Commissioner Kara M. Stein, the sole dissenter for each proposal, referred to the proposals as "Regulation Status Quo" and commented that, in her view, the proposals are inadequate for the protection of retail investors who continue to suffer confusion about the relationships and obligations of the investment professionals they engage.[5] Commissioner Stein also expressed displeasure at the continuing ambiguity of the "best interest" standard as proposed in Regulation Best Interest.[6] Commissioners Robert J. Jackson, Jr. and Hester M.

Peirce, who supported issuing the proposed package for public comment, stopped short, however, of expressing support for the proposals themselves.[7]

Next Steps: The SEC is seeking comment from the public on all aspects of nearly every feature in the three proposals and has included over 450 questions on more than 40 topics. Comments are due by August 7, 2018.

The package of proposed rules and interpretations, which is extensive, will need to be reviewed and considered carefully by broker-dealers, investment advisers and investment professionals and their advisers. Taken as a whole, proposed Regulation Best Interest and Form CRS would impose meaningful additional disclosure and compliance obligations on impacted firms. Various requirements are detailed and prescriptive—going so far as to specify the font type and size of certain required disclosures—and could easily result in violations if firms are not carefully monitoring their compliance with these requirements. Commenters should consider addressing specific aspects of the proposals that could impose undue compliance burdens.

Although thoughtfully written, the SEC's proposed interpretation regarding the standard of conduct for investment advisers under the Advisers Act appears to introduce some uncertainty as to whether disclosure alone may be sufficient for an investment adviser to comply with its fiduciary duties in appropriate circumstances. This would be at odds with the long-standing legal principle that an investment adviser must *either* eliminate or expose all conflicts of interest that might incline the investment adviser to render advice that is not disinterested.[8] The Investment Advisers Release also creates a risk of requiring investment advisers to develop separate tiers of clients based on each client's relative sophistication and ability to understand the investment adviser's disclosed conflicts of interest. Commenters may wish to focus on the legal principles governing investment advisers' fiduciary duties and the role of disclosure in their relationships with clients.

This memorandum summarizes the key aspects of the SEC's package of proposed rules and interpretations.

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I. REGULATION BEST INTEREST

In its release titled "Regulation Best Interest" (Release No. 34-83062; File No. S7-07-18) (the "Regulation Best Interest Release"), the SEC proposed a new rule under the Securities Exchange Act of 1934 ("Exchange Act") that would establish a standard of conduct for a broker-dealer and natural persons who are associated persons of a broker-dealer (together, a "broker-dealer") when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.[9]

A. BACKGROUND

The Exchange Act and self-regulatory organization ("SRO") rules provide a comprehensive regulatory framework that governs the obligations that attach when a broker-dealer makes a recommendation to a customer. For instance, under existing federal securities laws and SRO rules, broker-dealers have a duty of fair dealing,[10] which requires broker-dealers to make only suitable recommendations to customers and to receive fair and reasonable compensation.[11] Nevertheless, these various conduct obligations have not required broker-dealers to make recommendations that are in a client's "best interest."

Over the past decade, concerns about the potentially harmful effects of broker-dealer conflicts of interest have drawn the increasing scrutiny of Congress and various governmental agencies, including, among others, the SEC and the U.S. Department of Labor ("DOL"), as well as SROs such as the Financial Industry Regulatory Authority ("FINRA").

For instance, Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), required the SEC to undertake a study to evaluate "the effectiveness of existing legal or regulatory standards of care (imposed by the SEC, a national securities association, and other federal or state authorities) for providing personalized investment advice and recommendations about securities to retail customers" and "whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute."[12]

In January 2011, the SEC issued the study (the "913 Study")[13] mandated by Section 913 of the Dodd-Frank Act. The 913 Study recommended that the SEC adopt and implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers who provide personalized investment advice about securities to retail investors. The 913 Study recommended a standard of conduct that would require firms "to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice."[14] Subsequently, in March 2013, the SEC issued a public request for data and other information in order to evaluate the standards of conduct and regulatory obligations applicable to broker-dealers and investment advisers.[15] The SEC received more than 250

responses that expressed general support for a uniform fiduciary standard of conduct, although there was no consensus on what this standard should encompass.[16]

In November 2013, the SEC's Investment Advisory Committee ("IAC") recommended, among other proposals, implementing a uniform fiduciary standard either through (i) a narrowing of the broker-dealer exclusion from the definition of "investment adviser" under the Advisers Act (see Section I.F) or (ii) new rules under Section 913 of the Dodd-Frank Act to adopt a principles-based fiduciary duty and to permit certain sales-related conflicts only upon full disclosure and appropriate management.[17]

Meanwhile, beginning in 2010, the DOL had engaged in rulemaking to specify the definition of "fiduciary" in connection with the provision of investment advice under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[18] In April 2016, the DOL adopted a new rule ("DOL Fiduciary Rule") that would treat as a "fiduciary" any person who provides investment advice or recommendations for compensation with respect to assets of an ERISA plan or an Individual Retirement Account ("IRA").[19] The DOL Fiduciary Rule broadly expanded the circumstances in which broker-dealers would be subject to the prohibited transaction provisions of ERISA and the Code. One of the effects of the broad nature of the DOL Fiduciary Rule was that broker-dealers would be prohibited from engaging in purchases and sales for their own account (*i.e.*, engaging in principal transactions) and from receiving compensation from third parties (including transaction-based fees, a common form of broker-dealer compensation) in connection with transactions involving an ERISA plan or IRA. To avoid this result, which could effectively eliminate a broker-dealer's ability or willingness to provide investment advice with respect to investors' retirement assets, the DOL published two exemptions from the prohibited transaction provisions:

- the Best Interest Contract Exemption ("BIC Exemption"); and
- the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plan and IRAs ("Principal Transactions Exemption").

The BIC Exemption and the Principal Transactions Exemption would allow persons deemed fiduciaries under the DOL Fiduciary Rule to receive compensation and to engage in certain principal transactions that would otherwise be prohibited transactions. Under a two-phase approach, the revised definition of "fiduciary" under the DOL Fiduciary Rule as well as certain standards of impartial conduct under the BIC Exemption[20] became effective on June 9, 2017, while compliance with the remaining conditions of the BIC Exemption and the Principal Transactions Exemption would not be required until July 1, 2019.[21] However, on March 15, 2018, the United States Court of Appeals for the Fifth Circuit vacated *in toto* the DOL Fiduciary Rule, citing a conflict with the statutory text of ERISA and the Code and admonishing the DOL for infringing on the SEC's regulatory mandate under the Dodd-Frank Act. The DOL's opportunity to appeal the decision expired on April 30, 2018.[22] On May 7, 2018 the DOL issued a Field Assistance Bulletin describing the DOL's temporary enforcement policy related to the DOL Fiduciary Rule, indicating

that "from June 9, 2017, until after regulations or exemptions or other administrative guidance has [*sic*] been issued, the [DOL] will not pursue prohibited transactions claims against investment advice fiduciaries who are working diligently and in good faith to comply with the impartial conduct standards for transactions that would have been exempted in the BIC Exemption and Principal Transactions Exemption, or treat such fiduciaries as violating the applicable prohibited transaction rules."[23]

In June 2017, the SEC had sought public comment on a variety of issues associated with standards of conduct for investment professionals.[24] The SEC received approximately 250 comments which suggested, among other things, that due to the complex and burdensome requirements imposed as part of the BIC Exemption and the associated litigation risk, broker-dealers were changing the types of products and accounts offered to retirement investors. The comments also expressed concerns that retirement investors would be harmed through reduced product choice, increased cost for retirement advice, or lost or restricted access to advice.

The table below summarizes the key events leading up to the proposed Regulation Best Interest.

Date	*Event*	*Outcome*
July 2010	Enactment of Dodd-Frank Act	Section 913 mandates SEC Study relating to personalized investment advice and recommendations about securities to retail customers.
January 2011	913 Study	The 913 Study recommended SEC adoption and implementation of uniform fiduciary standard of conduct for broker-dealers and investment advisers.
March 2013	SEC Request for Comment	The SEC received approximately 250 comments that expressed general support for proposals of 913 Study.
November 2013	IAC Recommendation	The IAC recommended two options for SEC action in respect of proposals of 913 Study.
April 2016	DOL Rulemaking	The DOL Fiduciary Rule and certain standards of conduct became effective on June 9, 2017; compliance with conditions of certain exemptions to DOL Fiduciary Rule was delayed until July 1, 2019.
June 2017	SEC Request for Comment	The SEC received approximately 250 comments that were considered in drafting Regulation Best Interest.

Date	Event	Outcome
March 15, 2018	U.S. Court of Appeals for the Fifth Circuit ruling	The DOL Fiduciary Rule was vacated by the Fifth Circuit in *Chamber of Commerce of the U.S.A. et al. v. U.S. Department of Labor, et al.*
April 18, 2018	SEC Open Meeting	SEC Commissioners approved proposed Regulation Best Interest and the request for comments by a vote of 4-1, triggering a 90-day comment period.

According to the SEC, Proposed Regulation Best Interest is intended to address the ambiguity surrounding the standard of conduct under the current regulatory framework applicable to broker-dealers under the Exchange Act and SRO rules.

B. OVERVIEW OF REGULATION BEST INTEREST

Proposed Regulation Best Interest would establish a standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.[25] It is intended to apply in addition to any obligations under the Exchange Act, along with any rules the SEC may adopt thereunder, and any other applicable provisions of the federal securities laws and related rules and regulations. Further, proposed Regulation Best Interest is intended to be consistent with and build upon relevant SRO rules and the existing regulatory regime. Proposed Regulation Best Interest and its specific obligations would not apply to advice provided by an investment adviser or a dual-registrant acting in the capacity of an investment adviser (further discussed in I.C.4 below).

The standard of conduct for broker-dealers under the proposed Regulation Best Interest 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.[26]

The Regulation Best Interest Release notes that, in developing proposed Regulation Best Interest, the SEC has drawn from principles that apply to the provision of investment advice under other regulatory regimes—including SRO rules, state common law, the Advisers Act, the standards set forth in Section 913(g) of the Dodd-Frank Act, the 913 Study recommendations and any duties that would apply to broker-dealers as a result of the DOL Fiduciary Rule and the related BIC Exemption and Principal Transactions Exemption.[27]

The table below briefly summarizes the applicable standards of conduct under the 913 Study, the DOL Fiduciary Rule, the BIC Exemption to the DOL Fiduciary Rule, the Advisers Act and proposed Regulation Best Interest.

Standards of Conduct for Broker-Dealers and Investment Advisers	
913 Study	A uniform fiduciary standard that would require a broker-dealer or investment adviser, when providing personalized investment advice about securities to retail customers, to act in the best interest of the customer without regard to its own financial or other interests.
DOL Fiduciary Rule	A person providing investment advice or recommendations for compensation with respect to assets of an ERISA plan or IRA would be held to be a fiduciary and would be required at all times to serve the best interest of the investor and put the investor's interests above its own (subject to the BIC Exemption and/or Principal Transactions Exemption, as applicable).
BIC Exemption to DOL Fiduciary Rule	A person providing investment advice or recommendations for compensation under the BIC Exemption's Impartial Conduct Standard would be required to act in the best interest of the retirement investor and to provide advice with "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use… ***without regard to [its own] financial or other interests***."
Investment Advisers Act	Investment advisers owe a ***fiduciary*** duty to serve the best interest of the client, which includes an obligation not to subrogate the clients' interest to its own.[28]
Proposed Regulation Best Interest	A broker-dealer would be required to act in the best interest of the retail customer at the time a recommendation is made ***without placing its financial or other interests ahead of the interest of the retail customer*** by satisfying the specific obligations set forth in proposed Regulation Best Interest.

As shown in the table above, the standard of conduct proposed for Regulation Best Interest departs from the standard proposed by the SEC in the 913 Study for broker-dealers as it replaces the phrase "without regard to the financial or other interest" with the phrase "without placing the financial or other interest… ahead of the interest of the retail customer." In the Regulation Best Interest Release, the SEC expressed

concern that the "without regard to" language could be inappropriately construed to require a broker-dealer to eliminate all of its conflicts, which is not its intention. Rather, the SEC acknowledges in the Regulation Best Interest Release that conflicts of interest are inherent in any principal-agent relationship. Despite using different language, the SEC believes its proposal reflects the underlying intent of previous standards of conduct: although a broker-dealer's financial interests can and will inevitably exist, they cannot be the predominant motivating factor behind a recommendation to an investor.

The SEC has proposed that the "best interest" standard under Regulation Best Interest will be met upon satisfaction by a broker-dealer of the following obligations:

- **Disclosure Obligation**: the broker-dealer, prior to or at the time of making a recommendation, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship, including all material conflicts of interest that are associated with the recommendation.
- **Care Obligation**: the broker-dealer, in making the recommendation, exercises reasonable diligence, care, skill, and prudence.
- **Conflict of Interest Obligations**:
  - the broker-dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with a recommendation of any securities transaction or investment strategy involving securities to a retail customer; and
  - the broker-dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

The SEC notes in the Regulation Best Interest Release that scienter would not be required to establish a violation of proposed Regulation Best Interest—thus, any failure to comply with the specific obligations would result in a violation. Further discussion of each of these obligations is set forth in Section I.D below.

As proposed, a broker-dealer would not be able to waive compliance with proposed Regulation Best Interest, nor could a retail customer agree to waive his or her protection under proposed Regulation Best Interest.[29] In other words, the scope of proposed Regulation Best Interest cannot be reduced by contract. However, a broker-dealer may agree with a retail customer by contract to take on additional obligations beyond those imposed by proposed Regulation Best Interest, such as agreeing to hold itself to a fiduciary standard or provide ongoing monitoring for purposes of recommending changes in investments.

The SEC states that it does not intend proposed Regulation Best Interest to create a new private right of action or right of rescission.

It is important to note that proposed Regulation Best Interest focuses solely on enhancements to the broker-dealer regulatory regime. It is intended to be separate and distinct from the fiduciary standard applicable to investment advisers under the Advisers Act. A discussion of the SEC's historical

interpretations of the scope and nature of an investment adviser's fiduciary obligations, as well as its proposed interpretation, under the Advisers Act is set forth in Section II below.

C. KEY TERMS AND SCOPE OF BEST INTEREST OBLIGATION

1. "Best Interest"

In the Regulation Best Interest Release, the SEC has not defined "best interest." Instead, it proposed that a determination of whether a broker-dealer acted in the best interest of a retail customer when making a recommendation will turn on the facts and circumstances of the particular recommendation and the particular retail customer, along with the facts and circumstances of how the component obligations under proposed Regulation Best Interest are satisfied. As shown in the table below, certain practices would not be *per se* prohibited by proposed Regulation Best Interest to the extent broker-dealers satisfy the component obligations thereunder.

Practices Not *Per Se* Prohibited under Proposed Regulation Best Interest
• Charging commissions or other transaction-based fees • Receiving or providing differential compensation based on the product sold • Receiving third-party compensation • Recommending proprietary products, products of affiliates or a limited range of products • Recommending a security underwritten by the broker-dealer or a broker-dealer affiliate, including initial public offerings ("IPOs") • Recommending that a transaction be executed in a principal capacity • Recommending complex products • Allocating trades and research, including allocating investment opportunities (*e.g.*, IPO allocations or proprietary research or advice) among different types of customers and between retail customers and the broker-dealer's own account • Considering cost to the broker-dealer of effecting the transaction or strategy on behalf of the customer (for example, the effort or cost of buying or selling an illiquid security) • Accepting a retail customer's order that is contrary to the broker-dealer's recommendations

2. "When Making a Recommendation," "At Time a Recommendation Is Made"

The SEC has proposed that Regulation Best Interest would apply when a broker-dealer is making a recommendation about any securities transaction or investment strategy to a retail customer. "Recommendation" would have the same meaning as the term is currently interpreted under federal securities laws and SRO rules.[30] Consistent with existing broker-dealer regulation, the SEC's view of

whether a recommendation has been given will turn on the facts and circumstances of the particular situation. In determining whether a broker-dealer has made a recommendation for the purposes of proposed Regulation Best Interest, the SEC points to factors that have historically been considered in the context of broker-dealer suitability obligations, such as whether a communication "reasonably could be viewed as a call to action" and "reasonably would influence an investor to trade a particular security or group of securities."[31] Examples of communications that would not rise to the level of a recommendation include providing general investor education (*e.g.*, a brochure discussing asset allocation strategies) or limited investment analysis (*e.g.*, a retirement savings calculator). Consistent with existing interpretations and guidance on what constitutes a recommendation,[32] the proposed Regulation Best Interest obligation would also apply to activity that has been interpreted as "implicit recommendations," such as through a broker-dealer's execution of discretionary transactions or making a recommendation to a brokerage customer in a non-discretionary account.

The Regulation Best Interest obligation would be triggered each time a recommendation is made by a broker-dealer to a retail customer. The obligation would not:

- extend beyond a particular recommendation or generally require a broker-dealer to have a continuous duty to a retail customer or to impose a duty to monitor the performance of the account;
- require the broker-dealer to refuse to accept a customer's order that is contrary to a broker-dealer's recommendation; or
- apply to self-directed or otherwise unsolicited transactions by a retail customer.

3. "Any Securities Transaction or Investment Strategy"

Proposed Regulation Best Interest would apply to recommendations of any securities transaction, whether a sale, purchase or exchange, and of any investment strategy involving securities to retail customers. The obligation is not proposed to extend to recommendations of account types generally, unless the recommendation is tied to a securities transaction (*e.g.*, rollovers or transfers of assets into ERISA accounts and IRAs).

4. "Retail Customer"

"Retail Customer" would be defined as "a person, or the legal representative of such person, who (1) 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 (2) uses the recommendation primarily for personal, family, or household purposes." This definition generally tracks the definition of "retail customer" under Section 913(a) of the Dodd-Frank Act. However, it should be noted that the definition of "retail customer" differs from the definition of "retail investor" in Form CRS (*see* Section III below).

"Retail Customer" in Proposed Regulation Best Interest	"Retail Investor" in Form CRS
A person, or the legal representative of such person, who: • (1) receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and • (2) uses the recommendation primarily for personal, family, or household purposes.	A prospective or existing client or customer who is a natural person, regardless of the individual's net worth. This could include: • accredited investors, • qualified clients, and • qualified purchasers.

5. Application to Investment Advisers and Dual-Registrants

The SEC intends for Regulation Best Interest to apply only in the context of a brokerage relationship with a brokerage customer.[33] Accordingly, proposed Regulation Best Interest would not apply to the relationship between an investment adviser and its advisory client (or any recommendations made by an investment adviser to an advisory client).

Somewhat more complicated is the application of proposed Regulation Best Interest to dual-registrants. The SEC proposes that Regulation Best Interest would apply to a dual-registrant only when it is making a recommendation in its capacity as a broker-dealer. Proposed Regulation Best Interest would not apply to advice provided by a dual-registrant when acting in the capacity of an investment adviser, even if the person to whom the recommendation is made also has a brokerage relationship with the dual-registrant or even if the dual-registrant subsequently executes the transaction in its capacity as a broker-dealer.

If a "retail customer" is receiving a recommendation from:	
A broker-dealer…	Regulation Best Interest applies.
An investment adviser…	Regulation Best Interest does not apply.
A dual-registrant…	Regulation Best Interest applies only when the recommendation is made in the registrant's capacity as a broker-dealer; it does not apply when the recommendation is made in the registrant's capacity as an investment adviser.

Determining whether a recommendation made by a dual-registrant is in its capacity as broker-dealer requires a facts and circumstances analysis. Factors that should be considered include the type of account (*e.g.*, advisory or brokerage), how the account is described, the type of compensation, and the

extent to which the dual-registrant made clear the capacity in which it was acting to the customer or client. Where a dual-registrant acts in the capacity of an investment adviser, and is therefore not subject to proposed Regulation Best Interest, the adviser would be required to comply with its fiduciary obligations under the Advisers Act, as described in more detail in Section II below.

D. COMPONENTS OF REGULATION BEST INTEREST

The obligation to "act in the best interest of the retail customer… without placing the financial or other interest of the [broker-dealer] ahead of the retail customer" would be satisfied if the broker-dealer complies with four component obligations: a Disclosure Obligation, a Care Obligation, and two Conflict of Interest Obligations. In order to provide greater clarity to broker-dealers about the requirements of the best interest standard of conduct, Regulation Best Interest as proposed would not impose any obligations other than these four specified obligations.

1. Disclosure Obligation

The Disclosure Obligation would require that a broker-dealer "*prior to or at the time of [a] recommendation, reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest associated with the recommendation*." The Disclosure Obligation under proposed Regulation Best Interest and the requirements of Form CRS (discussed in Section III.A below) are designed to complement and build upon each other.[34]

Material Facts Relating to the Scope and Terms of the Relationship with the Retail Customer

The Disclosure Obligation would apply to any "material facts relating to the scope and terms of the relationship with the retail customer." Some examples include:

- whether the broker-dealer is acting in a broker-dealer capacity at the time of the recommendation;[35]
- the fees and charges that apply to the retail customer's transactions, holdings, and accounts; and
- the type and scope of services provided by the broker-dealer, including, *e.g.*, monitoring the performance of the retail customer's account.

While the examples above reflect what the SEC believes would generally be material facts regarding the scope and terms of the relationship, broker-dealers would need to determine if any other material facts relate to the scope and terms of the relationship based on the facts and circumstances.

Material Conflicts of Interest Associated with the Recommendation

The Disclosure Obligation would apply to any "material conflict of interest," which would be defined as a conflict of interest that a reasonable person would expect might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested. The SEC notes in the Regulation

Best Interest Release that its proposed interpretation is based on SEC precedent under the Advisers Act as the SEC believes it is appropriate to interpret the term in accordance with existing and well-established SEC precedent. The SEC indicates in the Regulation Best Interest Release that material conflicts associated with recommendations relating to the following should be disclosed:

- proprietary products, products of affiliates, or a limited range of products;
- one share class versus another share class of a mutual fund;
- securities underwritten by the firm or a broker-dealer affiliate;
- the rollover or transfer of assets from one type of account to another (including, *e.g.*, recommendations to roll over or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction); and
- allocation of investment opportunities among retail customers (*e.g.*, IPO allocation).

A broker-dealer should also consider whether any material conflicts arise from financial incentives that would need to be disclosed and mitigated, including those associated with:

- compensation practices established by the broker-dealer, including fees and other charges for the services provided and products sold;
- employee compensation or employment incentives (*e.g.*, quotas, bonuses, sales contests, special awards, differential or variable compensation, incentives tied to appraisals or performance reviews);
- compensation practices involving third parties, including both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third parties (*e.g.*, sub-accounting or administrative services provided to a mutual fund);
- receipt of commissions or sales charges, or other fees or financial incentives, or differential or variable compensation, whether paid by the retail customer or a third party;
- sales of proprietary products or services, or products of affiliates; and
- transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.

The Disclosure Obligation would apply to the extent a broker-dealer determines to disclose and not eliminate a material conflict of interest pursuant to the Conflict of Interest Obligations (described in Section I.D.3 below).

Form, Timing and Method of Delivery

In order to provide flexibility to broker-dealers, proposed Regulation Best Interest would not mandate the form, specific timing or method for delivering disclosure pursuant to the Disclosure Obligation, other than the general requirement that the disclosure be made "prior to or at the time" of the recommendation.

Possible Timing and Frequency of Disclosure	
At the beginning of a relationship	*e.g.*, in a relationship guide (such as or in addition to Form CRS) or in written communications with the retail customer (such as the account opening agreement)
On a regular or periodic basis	*e.g.*, on a quarterly or annual basis, when any previously disclosed information becomes materially inaccurate, or when there is new relevant material information
At other specified instances	*e.g.*, before making a particular recommendation or at the point of sale
At multiple instances during the relationship	(see above)

Reasonable Disclosure

In order to "reasonably disclose" material facts relating to the scope and terms of the relationship, a broker-dealer would need to give sufficient information to a retail customer to enable him or her to make an informed decision with regard to the recommendation, which would need to be determined on a case-by-case basis.[36] Compliance with the Disclosure Obligation would be measured against a negligence standard instead of strict liability.[37]

2. Care Obligation

The Care Obligation generally draws from principles similar to those underlying DOL's "best interest" Impartial Conduct Standard, as described by DOL in the BIC Exemption, [38] and echoes the general suitability, customer-specific suitability and series-of-transactions suitability determinations required by FINRA Rule 2111.05.[39]

In making the recommendation, the broker-dealer "*must exercise reasonable diligence, care, skill, and prudence*" to satisfy the obligations outlined in the table below.[40]

Care Obligation	Methods of Satisfying Obligation
"(1) understand the potential risks and rewards associated with the recommendation, and have a ***reasonable basis*** *to believe that the recommendation could be in the* ***best interest of at least some retail customers****."*	• Undertaking reasonable diligence by considering factors such as the costs, investment objectives, characteristics associated with a product or strategy, liquidity, risks and potential benefits, volatility, likely performance of market and economic conditions, the expected return of the security or investment strategy, and the financial and other benefits to the broker-dealer; and • Having a reasonable basis to believe that the recommendations could be in the best interest of at least some retail customers based on that understanding.

"(2) have a ***reasonable basis*** *to believe that the recommendation is in the* ***best interest of a particular retail customer*** *based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation."*	• Undertaking reasonable diligence by considering factors such as the costs, investment objectives and characteristics associated with a product or strategy, and the financial and other benefits to the broker-dealer;
	• Undertaking reasonable diligence to ascertain the retail customer's investment profile, which includes, but is not limited to, the retail customer's:
	  • age;
	  • other investments;
	  • financial situation and needs;
	  • tax status;
	  • investment objectives;
	  • investment experience;
	  • investment time horizon;
	  • liquidity needs;
	  • risk tolerance; and
	  • other information disclosed to the broker-dealer in connection with a recommendation; and
	• Having a reasonable basis to believe that the recommendations could be in the best interest of a particular retail customer based on that understanding.

Care Obligation	Methods of Satisfying Obligation
*"(3) have a **reasonable basis** to believe that when **taken together** a series of recommended transactions—even if in the retail customer's best interest when viewed in isolation—is not excessive and is in the **best interest of the retail customer** in light of the retail customer's investment profile."*	• Undertaking reasonable diligence by considering factors such as turnover rate, cost-to-equity ratio, and the use of in-and-out trading in a customer's account; • Undertaking reasonable diligence to ascertain the retail customer's investment profile; and • Having a reasonable basis to believe that the series of recommended transactions is not excessive and is in the best interest of a particular retail customer based on that understanding.

The Care Obligation encourages the broker-dealer to consider any reasonable alternatives in determining whether it has a reasonable basis for making the recommendation. Under this approach, a broker-dealer would not be expected to analyze all possible securities, all other products or all investment strategies. Further, as long as the Care Obligation is satisfied and associated conflicts are disclosed or eliminated (*see* Section I.D.3 below), proposed Regulation Best Interest does not prohibit recommendations from a limited range of products, or recommendations of proprietary products, products of affiliates, or principal transactions.

Further, the Care Obligation goes beyond a broker-dealer's existing suitability obligations derived from the antifraud provisions of the federal securities laws; for instance, a violation of the suitability obligation requires an element of fraud or deceit,[41] whereas the Care Obligation does not. Thus, a key difference resulting from the obligations imposed by proposed Regulation Best Interest as compared to a broker-dealer's existing suitability obligations under the antifraud provisions of the federal securities laws is that a broker-dealer would not be able to satisfy its Care Obligation through disclosure alone.

In addition, the Regulation Best Interest Release indicates that the SEC would consider the cost of the security or strategy and any associated financial incentives as the more important factors (of the many factors that should be considered) in understanding and analyzing whether to recommend a security or an investment strategy under the Care Obligation. Other factors that would be important include the product's or strategy's investment objectives, certain characteristic features, liquidity, risks and potential benefits, volatility, and likely performance in a variety of market and economic conditions.

It should be noted that proposed Regulation Best Interest would not necessarily obligate a broker-dealer to recommend the "least expensive" or the "least remunerative" security or investment strategy, provided that the broker-dealer complies with the Disclosure, Care and Conflict of Interest Obligations. Still, under the Care Obligation, a broker-dealer could not be expected to have a reasonable basis to believe that a

recommended security is in the best interest of a retail customer if it is more costly than a reasonably available alternative offered by the broker-dealer and the characteristics of the securities are otherwise identical.

3. Conflict of Interest Obligations

The Conflict of Interest Obligations would require a broker-dealer to:

- establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose, or eliminate, all material conflicts of interest that are associated with recommendations covered by Regulation Best Interest; and
- establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

A principles-based approach to the Conflict of Interest Obligations allows broker-dealers the flexibility to establish a supervisory system in a manner that best reflects their business practices. For instance, the SEC would deem it reasonable for broker-dealers to use a risk-based compliance and supervisory system to promote compliance with the Conflict of Interest Obligations, rather than conducting a detailed review of each recommendation of a securities transaction or security-related investment strategy to a retail customer.

In the SEC's view, so long as a broker-dealer's policies and procedures are reasonably designed to meet its Conflict of Interest Obligations, the broker-dealer would be permitted to exercise its own judgment as to whether the conflict can be effectively disclosed (as discussed in Section I.D.1), to determine what conflict mitigation methods may be appropriate and to determine whether or how to eliminate a conflict. Whether a broker-dealer's policies and procedures are reasonably designed would depend on the relevant facts and circumstances.

In the Regulation Best Interest Release, the SEC encourages broker-dealers to consider developing policies and procedures outlining:

- how the firm identifies its material conflicts of interest, clearly identifying all such material conflicts of interest and specifying how the broker-dealer intends to address each conflict;
- the firm's compliance review and monitoring systems;
- processes to escalate identified instances of noncompliance to appropriate personnel for remediation;
- procedures that clearly designate responsibility to business lines personnel for supervision of functions and persons, including determination of compensation;
- processes for escalating conflicts of interest;
- processes for a periodic review and testing of the adequacy and effectiveness of policies and procedures; and
- training on the policies and procedures.

E. RECORDKEEPING AND RETENTION

Exchange Act Section 17(a)(1) requires registered broker-dealers to make and keep for prescribed periods such records as the SEC deems "necessary or appropriate in the public interest, for the protection of investors." Exchange Act Rules 17a-3 and 17a-4 specify minimum requirements with respect to the records that broker-dealers must make, and how long those records and other documents must be kept, respectively.

As shown in the table below, the SEC has proposed certain amendments to Rules 17a-3 and 17a-4 under Regulation Best Interest.

	Current Rule	Proposed Amendment under Regulation Best Interest
Rule 17a-3(a)(17)	Requires broker-dealers that make recommendations for accounts with a natural person as customer or owner to create and periodically update customer account information.	Adds new paragraph (a)(25) which would require, for each retail customer to whom a recommendation will be provided, a record of all information collected from and provided to the retail customer pursuant to Regulation Best Interest, as well as the identity of each natural person who is an associated person of a broker or dealer, if any, responsible for the account.
Rule 17a-4(e)(5)	Requires broker-dealers to maintain and preserve in an easily accessible place all account information required pursuant to Rule 17a-3(a)(17) for six years.	Would require broker-dealers to retain any information that the retail customer provides to the broker-dealer or the broker-dealer provides to the retail customer pursuant to proposed Rule 17a-3(a)(25), in addition to the existing requirement to retain information obtained pursuant to Rule 17a-3(a)(17).

Thus, the proposed amendments to Rule 17a-3(a)(17) and Rule 17a-4(e)(5) would require broker-dealers to retain all of the information collected from or provided to each retail customer pursuant to Regulation Best Interest for six years.

F. WHETHER THE EXERCISE OF INVESTMENT DISCRETION SHOULD BE VIEWED AS SOLELY INCIDENTAL TO THE BUSINESS OF A BROKER OR DEALER

The Advisers Act regulates the activities of certain "investment advisers," defined in Section 202(a)(11) of the Advisers Act as persons who engage in the business of advising others about securities for compensation. Section 202(a)(11)(C) excludes from the definition of "investment adviser" a broker-dealer whose performance of such advisory services is solely incidental to the conduct of his business as a broker-dealer and who receives no special compensation for those services (the "broker-dealer exclusion").

In 2005, the SEC adopted an interpretive rule that, among other things, provided that broker-dealers are excluded from the Advisers Act for any accounts over which they exercise only temporary or limited investment discretion.[42] In 2007, this rule was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on the grounds that the SEC lacked authority for expanding the exclusion under Section 202(a)(11)(C) of the Advisers Act.

While a broker-dealer's ability to engage in discretionary activity is currently circumscribed by existing rules under the federal securities laws, SROs and state laws, in light of both proposed Regulation Best Interest and proposed Form CRS, the SEC is requesting public comment to consider the scope of the broker-dealer exclusion and whether a broker-dealer's provision of certain discretionary investment advice should be considered solely incidental to the conduct of the person's business as a broker-dealer.

II. INTERPRETATION OF STANDARD OF CONDUCT FOR INVESTMENT ADVISERS

In its release titled "Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation" (Release No. IA-4889; File No. S7-09-18) (the "Investment Advisers Release"), the SEC has proposed an interpretation of the standard of conduct for investment advisers under the Advisers Act. The SEC's stated purpose in issuing the Investment Advisers Release is to "reaffirm – and in some cases clarify" certain aspects of the fiduciary duty that an investment adviser owes to its clients under Section 206 of the Advisers Act. Although the SEC elected not to propose a uniform standard of conduct for broker-dealers and investment advisers as recommended by the 913 Study, the SEC notes that it continues to consider whether it can improve protection of investors through potential enhancements to the legal obligations of investment advisers.[43]

The Investment Advisers Release reaffirms that, unlike broker-dealers, an investment adviser owes a fiduciary duty to its clients under Section 206 of the Advisers Act. Although the fiduciary duty to which investment advisers are subject is not specifically defined in the Advisers Act or in SEC rules, equitable common law principles and Congressional intent reflect a requirement that an investment adviser, at all times, serve the best interest of its clients and not subordinate its clients' interest to its own.[44]

As discussed further below, the SEC has interpreted the fiduciary duty under the Advisers Act as comprised of a duty of care and a duty of loyalty, which include an affirmative duty of utmost good faith and full and fair disclosure of all material facts. The SEC notes in the Investment Advisers Release that "the investment adviser cannot disclose or negotiate away, and the investor cannot waive, this federal fiduciary duty."[45] Although the fiduciary duty cannot be waived, the Investment Advisers Release appears to introduce some uncertainty as to whether disclosure alone may be sufficient for an investment adviser to comply with its fiduciary duties in appropriate circumstances, which would be at odds with the long-standing principle that an investment adviser must *either* eliminate or expose all conflicts of interest that might incline the investment adviser to render advice that is not disinterested.[46] Indeed, the Investment Advisers Release itself (as discussed in Section B below) and prior SEC interpretations and case law indicate that full and fair disclosure alone may be sufficient in certain cases for an investment adviser to comply with its fiduciary duties.[47]

The Investment Advisers Release states that the SEC believes that the interpretations set forth therein are generally consistent with investment advisers' current understanding of the practices necessary to comply with their fiduciary duty under the Advisers Act; however, the SEC notes that "there may be certain current investment advisers who have interpreted their fiduciary duty to require something less, or something more, than the Commission's interpretation."[48] The SEC notes that the interpretation is not intended to be the exclusive resource for understanding the principles relevant to an adviser's fiduciary duty.

The table below summarizes the key differences in the standard of conduct that would apply to investment advisers and broker-dealers under the proposed rules and interpretations.

	Standard of Conduct	***Type of Client to Which Standard Applies***
Investment Advisers	Investment advisers owe a ***fiduciary*** duty to serve the best interest of the client, which includes an obligation not to subrogate the clients' interest to its own[49]	All clients
Broker-Dealers Under Proposed Regulation Best Interest	Broker-dealers must act in the ***best interest*** of the client at the time of making a recommendation without placing the financial or other interest of the broker-dealer ahead of the interest of the client by satisfying the specific obligations set forth in proposed Regulation Best Interest	"Retail customers" as defined in proposed Regulation Best Interest

A. DUTY OF CARE

As fiduciaries, investment advisers owe their clients a duty of care.[50] The SEC has indicated that the duty of care includes, among other things:

- the duty to act and to provide advice that is in the best interest of the client;
- the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades; and
- the duty to provide advice and monitoring over the course of the relationship.

1. Duty to Provide Advice that Is in the Client's Best Interest

In the context of providing personalized investment advice, the SEC interprets the duty of care as including a duty to make a reasonable inquiry into a client's financial situation, level of financial sophistication, investment experience, and investment objectives (referred to collectively as the client's "investment profile") and a duty to provide personalized advice that is suitable for and in the best interest of the client based on the client's investment profile.

According to the SEC, the nature and extent of the adviser's inquiry into the client's investment profile will necessarily turn on what is reasonable under the circumstances, including the nature of the agreed-upon advisory services, the nature and complexity of the anticipated investment advice, and the investment profile of the client. An adviser is expected to update a client's investment profile in order to adjust its advice to reflect any changed circumstances.[51]

An investment adviser must also have a reasonable belief that the personalized advice is suitable for and in the best interest of the client based on the client's investment profile. Important factors to consider when determining whether a security or investment strategy involving a security is in the best interest of the client include the cost (including fees and compensation) associated with investment advice, the investment product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions.[52] The SEC's interpretation of the duty of care requires that advisers conduct a reasonable investigation into an investment sufficient that its advice is not based on materially inaccurate or incomplete information.[53]

The Investment Advisers Release specifically notes that cost is just one of a number of factors to be considered by advisers and, while generally an important factor, the fiduciary duty does not necessarily require an adviser to recommend the lowest-cost investment product or strategy to a client.[54] In the SEC's view, an adviser would not satisfy its fiduciary duty to provide advice that is in the client's best interest by simply advising its client to invest in the least expensive or least remunerative investment product or strategy without any further analysis of other factors in the context of the portfolio that the adviser manages for the client and the client's investment profile.

2. Duty to Seek Best Execution

In a situation where an investment adviser has the responsibility to select the broker-dealer(s) to execute client trades, an adviser has the duty to seek best execution of a client's transactions.[55]

In order to meet this obligation, an investment adviser must seek to obtain the execution of transactions for each of its clients such that the client's total cost or proceeds in each transaction are the most favorable under the circumstances. The adviser fulfills this duty by executing securities transactions on behalf of a client with the goal of maximizing value for the client under the particular circumstances occurring at the time of the transaction. In the SEC's view, maximizing value can encompass more than just minimizing cost and the determinative factor for maximizing is whether the transaction represents the best qualitative execution.[56]

3. Duty to Act and to Provide Advice and Monitoring over the Course of the Relationship

The SEC has interpreted the duty of care of an investment adviser as encompassing a duty to provide advice and monitoring over the course of a relationship with a client.[57] An adviser is, therefore, required to provide advice and services to a client over the course of the relationship at a frequency that is both in the best interest of the client and consistent with the scope of advisory services agreed upon between the investment adviser and the client.

B. DUTY OF LOYALTY

The duty of loyalty requires an investment adviser to put its client's interests first.[58] The SEC's view is that this duty requires not only that an investment adviser not favor its own interests over those of a client, but also that the adviser not unfairly favor one client over another.[59] The SEC notes that the duty does not go so far as to require an adviser to have a *pro rata* allocation policy among clients, but allocation policies must be fair and, if they present a conflict, the adviser must fully and fairly disclose the conflict such that a client can provide informed consent.

In seeking to meet its duty of loyalty, an adviser must also make full and fair disclosure to its clients of all material facts relating to the advisory relationship and must seek to avoid conflicts of interest with its clients.[60] Disclosure must be clear and detailed enough for a client to make a reasonably informed decision about whether to provide informed consent to such conflicts.

The SEC notes in the Investment Advisers Release that disclosure of a conflict alone will not *always* be sufficient to satisfy the adviser's duty of loyalty and Section 206 of the Advisers Act.[61] In the SEC's opinion, disclosure will not have a prophylactic effect where (i) the facts and circumstances indicate that the client did not understand the nature and import of the conflict or (ii) the nature and extent of the conflict mean that it would be difficult to provide disclosure that adequately conveys in a manner understandable to the client the potential effect of the conflict.[62] Where full and fair disclosure and informed consent are insufficient, the SEC explicitly expects an adviser "to eliminate the conflict or

adequately mitigate the conflict so that it can be more readily disclosed.[63] The SEC's interpretation in the Investment Advisers Release thus suggests that, with its emphasis on the understandability of disclosure, investment advisers may be required to develop separate tiers of clients based on each client's relative sophistication and ability to understand the investment adviser's disclosed conflicts of interest.

The SEC states that it is hopeful that, in issuing its interpretation, it "causes some investment advisers to properly identify circumstances in which disclosure alone cannot cure a conflict of interest…[and] lead those investment advisers to take additional steps to mitigate or eliminate the conflict."[64]

C. OTHER ISSUES

In 2011, the SEC issued the 913 Study, which included the recommendation, among others, that the SEC consider harmonizing certain regulatory requirements of broker-dealers and investment advisers where such harmonization appears likely to enhance meaningful investor protection. In response to this recommendation the SEC has identified certain areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context. The SEC has requested comments on the following three identified areas:

- whether there should be federal licensing and continuing education requirements for personnel of SEC-registered investment advisers;
- whether the SEC should propose rules to require registered investment advisers to provide clients with account statements; and
- whether SEC-registered investment advisers should be subject to financial responsibility requirements along the lines of those that apply to broker-dealers.

III. FORM CRS – CUSTOMER RELATIONSHIP SUMMARY

In its release titled "Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles" (Release No. 34-83063; IA-4888; File No. S7-08-18) (the "Relationship Summary Release"), the SEC expressed concern that retail investors are confused about the differences among registered investment advisers, registered broker-dealers, and dual-registrants (referred to together as "firms"), and the scope, nature and cost of the services they each provide.[65] The SEC has sought to address this concern by proposing a package of new and amended rules and forms under both the Advisers Act and the Exchange Act that:

- require registered broker-dealers and registered investment advisers to provide a Form CRS to retail investors;
- restrict broker-dealers and associated natural persons of broker-dealers from using the term "adviser" or "advisor" when communicating with a retail investor; and
- require firms and their associated natural persons and supervised persons, respectively, to disclose the firm's registration status with the SEC and an associated natural person's and/or supervised person's relationship with the firm in retail investor communications.

A. FORM CRS

1. Overview

The SEC has proposed that registered investment advisers and registered broker-dealers be required to deliver a relationship summary in Form CRS to retail investors. Form CRS would be provided to a retail investor at the beginning of his or her relationship with a firm, and updated by the firm following any material change in the relationship, and is intended to be in addition to (and not in lieu of) current disclosure and reporting requirements or other obligations for firms.

The SEC's stated goal in requiring firms to provide a Form CRS is to inform retail investors about the relationships and services offered by the firm, the standard of conduct and the fees and costs associated with those services, specified conflicts of interest, and whether the firm and its financial professionals currently have reportable legal or disciplinary events, all with a view to prompting retail investors to ask informed questions when engaging the firm's services.

For the purposes of the proposed rule, "retail investors" would include all natural persons, regardless of an individual's net worth, and thus would cover accredited investors, qualified clients or qualified purchasers. The definition would also include a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust. As noted in Section I.C.4 of this Memorandum, this definition of "retail customer" differs from the definition of "retail investor" under proposed Regulation Best Interest.

2. Content

In establishing Form CRS, the SEC has indicated that it hopes to create a tool that will facilitate comparisons across firms that offer the same or substantially similar services.[66] To that end, the SEC has proposed to significantly limit the discretion of firms in drafting their relationship summary by prescribing much of the content and presentation of information to be included in the Form CRS.[67] Only where a prescribed statement is not applicable to the firm's business, or would be misleading to a reasonable retail investor, would the proposed rules permit a firm to omit or modify that prescribed statement.

The below table summarizes the items that would need to be included in Form CRS. To aid firms in understanding the disclosures required by the proposed rule, the SEC has created three mock-ups of Form CRS, one for an investment advisory firm, one for a brokerage firm and one for a dual-registrant. Hyperlinks to these mock-ups are included in Annex A to this Memorandum.[68]

Item	Purpose	Information to Be Included
Introduction	To briefly highlight the types of accounts and services the firm offers	• Title • Firm name • SEC registration status • Date of the relationship summary • A brief explanation of the types of accounts and services the firm offers • SEC-prescribed wording about the nature of the firm (varies depending on whether the firm is a broker-dealer, investment adviser or both)

Relationships and Services	To provide information about the relationships between the firm and retail investors and the investment advisory account services and/or brokerage account services the firm provides	• A mix of SEC-prescribed wording and short narrative statements about the nature, scope, and duration of the firm's relationships and services
		• The required information varies depending on whether the firm is a broker-dealer, investment adviser or both, but generally includes information relating to:
		  ◦ the types of accounts and services the firm offers
		  ◦ the nature of the firm's fees (*e.g.*, transaction based fees)
		  ◦ whether the firm significantly limits the types of investments available to retail investors
		  ◦ regular communications the firm has with investors

Standard of Conduct to Retail Investors	To provide a brief overview of the standards of conduct to which broker-dealers and investment advisers must adhere	• SEC-prescribed wording that describes the standard of conduct applicable to investment advisers and/or broker-dealers • Dual-registrants would be required to provide this information in tabular format to facilitate comparison
Summary of Fees and Costs	To provide an overview and greater clarity with respect to the specified types of fees and expenses that retail investors will pay in connection with their brokerage and investment advisory accounts	• SEC-prescribed wording at the beginning of the section that prompts retail investors to seek personalized information on fees and costs • A description of the principal types of fees that the firm will charge and whether such fees vary and are negotiable; the description should include key factors to help an investor understand the fee they are likely to pay • A statement that retail investors may prefer

Item	Purpose	Information to Be Included
		paying a different type of fee in certain specified circumstances • A statement that some investments impose fees that will reduce the value of a retail investor's investment over time with relevant examples • Disclosure of any incentives the firm and its financial professionals have to put their own interests ahead of their retail investors' interests based on the account fee structure • SEC-prescribed wording about the nature of certain fees and incentives, which varies based on whether the firm is a broker-dealer, investment adviser or both • Dual-registrants would be required to provide this information in tabular format to facilitate comparison

Comparisons	To provide a comparison of typical brokerage or investment adviser accounts to help retail investors decide whether their needs might be better met with services from another type of firm	• Stand-alone investment advisers and stand-alone broker-dealers would be required to prepare this item under the following headings:
		  • "Compare with Typical Brokerage Accounts" (for stand-alone investment advisers)
		  • "Compare with Typical Advisory Accounts" (for stand-alone broker-dealers)
		• Stand-alone broker-dealers would include SEC-prescribed wording and a SEC-prescribed tabular chart about a generalized retail investment adviser. Stand-alone investment advisers would provide the same for a generalized broker-dealer

Conflicts of Interest	To provide retail investors with information so they are aware of and understand conflicts of interest at or before the start of their relationship with a firm	• SEC-prescribed language stating that the firm benefits from providing services to the investors • A statement disclosing: • any financial incentives the firm has to offer or recommend certain investments because (i) they are issued, sponsored or managed by the firm or its affiliates, (ii) third parties compensate the firm when it recommends or sells the investments or (iii) both, and examples of the types of investments (*e.g.*, mutual

Item	Purpose	Information to Be Included
		funds and variable annuities) associated with each of these conflicts • any revenue sharing arrangements • any principal trading engaged in by the firm, including that the firm can earn a profit on those trades and that the firm has an incentive to encourage the retail investor to trade with it
Additional Information	To help retail investors be better informed when they choose a firm and a financial professional, including by providing information on disciplinary history	• SEC-prescribed language encouraging investors to seek additional information, directing investors to a disciplinary history of the firm, and providing details of how to report complaints and problems • Information on whether the firm is required to disclose legal or disciplinary events to the SEC, self-regulatory organizations, state securities regulators or other jurisdictions • If legal or disciplinary events have been reported, inclusion of an affirmative statement that the firm and its financial professionals have reportable legal or disciplinary events
Key Questions	To encourage retail investors to have conversations with their financial professionals about how the firm's services, fees, conflicts and disciplinary events affect them	• A list of ten SEC-prescribed questions under the heading "Key Questions to Ask" • Firms must use formatting to make the questions noticeable and prominent

3. Filing Obligations

Under the proposed rule, firms would be required to electronically file Form CRS and any updates with the SEC. Such filings would therefore be subject to Section 207 of the Advisers Act and Section 18 of the Exchange Act, which make it unlawful to willfully make an untrue statement of material fact, or willfully omit to state any material fact required to be stated, in the Form CRS.

Firms would have the following filing obligations with respect to Form CRS:

Filing Obligations for Form CRS	
Investment Adviser	Electronically file on Investment Adviser Registration Depository ("IARD") and on its website before or at the time the firm enters into an investment advisory agreement with a retail investor.
Broker-dealer	Electronically file on the SEC's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") and on its website before or at the time a retail investor first engages the firm's services.
Dual-registrant	Electronically file on both IARD and EDGAR and on its website at the earlier of (i) entering into an investment advisory agreement with a retail investor or (ii) the retail investor engaging the firm's services.

4. Delivery Obligations

The proposed rule would require firms to deliver a Form CRS to each retail investor before or at the time the retail investor engages the firm's services. Specifically, firms would have the following delivery obligations with respect to Form CRS:

Delivery Obligations for Form CRS	
Investment Adviser	Deliver before or at the time the firm enters into an investment advisory agreement.
Broker-dealer	Deliver before or at the time a retail investor first engages the firm's services.
Dual-registrant	Deliver at the earlier of (i) entering into an investment advisory agreement with a retail investor or (ii) a retail investor engaging the firm's services.

Electronic delivery of Form CRS would be permitted. The proposed rule would also require firms to maintain a public website on which the Form CRS would be made readily accessible for retail investors.

5. Updating Requirements

A firm would be required to provide a Form CRS to an existing client or customer who is a retail investor before or at the time a new account is opened or whenever changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor. Further, a firm would be required to update its Form CRS within 30 days whenever any information contained therein becomes materially inaccurate.

6. Compliance Timetable

In order to provide adequate notice and opportunity for firms to comply with the proposed Form CRS filing obligations, the SEC would require compliance on the following timetable:

Proposed Compliance Dates for Form CRS	
Newly Registered Broker-dealers and New Applicants for Registration as Investment Advisers	(i) Electronically file or deliver Form CRS by the date six months after the effective date of the proposed new rules and amendments; or (ii) After that date, newly registered broker-dealers would be required to file their Form CRS by the date on which their registration becomes effective, and applicants for registration as an investment adviser would need to include in their applications a relationship summary that satisfies the requirements of Form ADV, Part 3: Form CRS.
Registered Investment Advisers and Broker-dealers (as of the effective date of the proposed new rules and amendments)	(i) Electronically file or deliver Form CRS as part of the firm's next annual updating amendment to Form ADV that is required by the date six months after the effective date of the proposed new rules and amendments; and (ii) Deliver Form CRS to all existing clients who are retail investors on an initial one-time basis within 30 days after the date the firm is first required to file its Form CRS with the SEC.

7. Recordkeeping Requirements

The SEC is also proposing amendments to Advisers Act rule 204-2 and Exchange Act rules 17a-3 and 17a-4,[69] which set forth requirements for maintaining, making and preserving specified books and records. As applied to Form CRS, the proposed changes would require firms to retain copies of each Form CRS and any updates, as well as a record of dates each relationship summary and each update was provided to a client or prospective client that subsequently becomes a client. These records would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204-2(a) of the Advisers Act, and the records for broker-dealers would be required to be maintained for a period of six years.[70] Like other records, Form CRS and any updates would be required to be provided by a firm to the SEC staff promptly upon request.[71]

B. RESTRICTIONS ON THE USE OF CERTAIN NAMES AND TITLES AND REQUIRED DISCLOSURES

According to the Relationship Summary Release, the SEC believes, based on the conclusions of multiple studies,[72] that certain names or titles used by broker-dealers, including "financial advisor," has contributed to confusion among retail investors as to the distinction among different firms and investment professionals, including the different regulatory regimes and business models under which they give advice. In particular, the SEC is of the view that some broker-dealers use certain names and titles in order to obscure the type of services they provide and mislead retail investors into believing that they are engaging with an investment adviser who is subject to an adviser's fiduciary duties.

While the SEC believes that Form CRS will help ameliorate some of this confusion, it remains concerned that the relationship summary is not a complete remedy.[73] In order to deter potentially misleading sales practices, the SEC has proposed to restrict certain persons from using the term "adviser" or "advisor" and require firms to disclose their regulatory status in retail investor communications.

Specifically, the proposed rule would restrict any broker or dealer, and any natural person who is an associated person of such broker or dealer, from using as part of its name or title the words "adviser" or "advisor" when communicating with a retail investor, unless (i) such broker or dealer is registered as an investment adviser under the Advisers Act or with a state, or (ii) any natural person who is an associated person of such broker or dealer is a supervised person of an investment adviser registered under Section 203 of the Advisers Act or with a state and such person provides investment advice to the retail investor on behalf of such investment adviser.

The proposed rule would permit firms that are dually registered as both an investment adviser (including state-registered investment advisers) and a broker-dealer to use the term "adviser" or "advisor" in their name or title. At the firm level, the SEC does not believe that the determination of when the restriction applies should be based on what capacity a dually registered firm is acting in a particular circumstance. Similarly, dual-hatted financial professionals of dually registered firms that provide services as an investment adviser to retail investors are permitted to use names or titles which include "adviser" and "advisor," even if, as a part of their business, they also provide brokerage services. In contrast, financial professionals of dually registered firms that only provide brokerage services will be restricted from using the title "adviser" or "advisor" despite such person's association with a dually registered firm.

In its release, the SEC goes to some length to note that its proposed restriction on the use of "adviser" and "advisor" in names and titles in combination with the requirement to deliver a Form CRS is, compared to alternatives it considered, the most simple and administrable approach to address the confusion about the difference between investment advisers and broker-dealers.[74]

C. DISCLOSURES ABOUT A FIRM'S REGULATORY STATUS AND A FINANCIAL PROFESSIONAL'S ASSOCIATION

The proposed rules in the Relationship Summary Release would require prominent disclosure by firms and financial professionals of their regulatory status in all print or electronic retail investor communications, including on business cards and televised or video presentations, as summarized in the table below.

Example Disclosure of Regulatory Status by Firms and Financial Professionals	
Investment Advisers registered under Section 203 of Investment Advisers Act	*"[Name of Firm], an SEC-registered investment adviser."*
Broker-dealers	*"[Name of Firm], an SEC-registered broker-dealer."*
Dual-registrants	*"[Name of Firm], an SEC-registered broker-dealer and SEC-registered investment adviser."*
Associated natural persons of a broker-dealer	*"[Name of professional], a [title] of [Name of Firm], an associated person of an SEC-registered broker-dealer."*
A supervised person of an investment adviser	*"[Name of professional], a [title] of [Name of Firm], a supervised person of an SEC-registered investment adviser."*
A person who is both an associated person of a broker-dealer and a supervised person of an investment adviser	*"[Name of professional], a [title] of [Name of Firm], an associated person of an SEC-registered broker-dealer and a supervised person of an SEC-registered investment adviser."*

Disclosure of registration status must be displayed prominently on investor communications, in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communications.

The SEC has not provided a specific deadline for implementation, instead proposing to stage the compliance date to ensure that firms and financial professionals can phase out older communications from circulation.

* * *

[1] SEC Press Release 2018-68, *SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals* (April 18, 2018).

[2] Securities and Exchange Commission, Release No. 34-83062; File No. S7-07-18, *Regulation Best Interest* (April 18, 2018) ("Regulation Best Interest Release").

[3] Securities and Exchange Commission, Release No. IA-4889; File No. S7-09-18, *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation* (April 18, 2018) ("Investment Advisers Release").

[4] Securities and Exchange Commission, Release No. 34-83063; IA-4888; File No. S7-08-18, *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles* (April 18, 2018) ("Relationship Summary Release").

[5] Securities and Exchange Commission Open Meeting on April 18, 2018, archived webcast *available at* https://www.sec.gov/video/webcast-archive-player.shtml?document_id=041818openmeeting.

[6] *Id*.

[7] *Id.*

[8] *See SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) ("SEC v. Capital Gains").

[9] As proposed, a "Natural Person who is an Associated Person" would have the meaning given under Section 3(a)(18) of the Exchange Act: "any partner, officer, director or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term." *See* Regulation Best Interest Release, at 71.

[10] *See Report of the Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 88-95, at 238 (1st Sess. 1963); *In re Richard N. Cea, et al.*, Exchange Act Release No. 8662 at 18 (Aug. 6, 1969) (Commission opinion involving excessive trading and recommendations of speculative securities without a reasonable basis); *In re Mac Robbins & Co. Inc.*, Exchange Act Release No. 6846, 41 S.E.C. 116 (July 11, 1962); *see also* FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) (requiring a member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade).

[11] *See Richard N. Cea*, Exchange Act Release No. 8662; *F.J. Kaufman and Co.*, Securities Exchange Act Release No. 27535 (Dec. 13, 1989); FINRA Rule 2111.01 (Suitability) ("Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of [FINRA's] Rules, with particular emphasis on the requirement to deal fairly with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct."). *See also* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf, at 51-53, 59; *A Joint Report of the SEC and the CFTC on Harmonization of Regulation* (Oct. 2009), *available at* http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf, at 61-64; FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2341 (Investment Company Securities). *See also* Sections 10(b) and 15(c) of the Exchange Act.

[12] Pub. L. 111-203, 124 Stat. 1376 (2010).

[13] *See* 913 Study*, supra* note 11.

[14] *Id*.

[15] *See Request for Data and Other Information: Duties of Brokers, Dealers and Investment Advisers*, Exchange Act Release No. 69013 (Mar. 1, 2013), *available at* http://www.sec.gov/rules/other/2013/34-69013.pdf; *see also SEC Seeks Information to Assess Standards of Conduct and Other Obligations of Broker-Dealers and Investment Advisers* (press release), *available at* http://www.sec.gov/news/press/2013/2013-32.htm.

[16] Comments submitted in response to the Request are *available at* https://www.sec.gov/comments/4-606/4-606.shtml.

[17] *Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty* (Nov. 2013), available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf.

[18] *See US Labor Department Proposes Rule Defining 'Fiduciaries' of Employee Benefit Plans*, U.S. Department of Labor Release No. 10-1472-NAT (October 21, 2010), *available at* https://www.dol.gov/opa/media/press/ebsa/EBSA20101472.htm; *US Labor Department Seeks Public Comment on Proposal to Protect Consumers from Conflicts of Interest in Retirement Advice*, U.S. Department of Labor Release No. 15-0655-NAT (April 14, 2015), *available at* https://www.dol.gov/newsroom/releases/ebsa/ebsa20150655.

[19] 29 CFR 2510.3-21. *See also* Sullivan & Cromwell LLP, *DOL Releases Final "Investment Advice" Regulation* (April 20, 2016), *available at* https://www.sullcrom.com/dol-releases-final-investment-advice-regulation-final-regulation.

[20] As part of the BIC Exemption, broker-dealers would need to provide advice in the investor's best interest; charge only reasonable compensation; and avoid misleading statements about fees and conflicts of interest (collectively, "Impartial Conduct Standards").

[21] *See* Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02) (Apr. 7, 2017), *available at* https://www.gpo.gov/fdsys/pkg/FR-2017-04-07/pdf/2017-06914.pdf.

See Principal Transactions Exemption; 18-Month Extension of Transition Period and Delay of Applicability Dates; Best Interest Contract Exemption (PTE 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016-02); Prohibited Transaction Exemption 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84-24), 82 FR 56545 (Nov. 29, 2017), *available at* https://federalregister.gov/d/2017-25760.

[22] *Chamber of Commerce of the U.S.A., et al.* v. *U.S. Dep't of Labor, et al*., No. 17-10238 (5th Cir.) (Mar. 15, 2018). The DOL has chosen not to file a motion for *en banc* review of the Court's March 15, 2018 decision (the filing deadline was April 30, 2018). Accordingly, the only remaining avenue for appeal would be a petition for a writ of *certiorari* to the Supreme Court.

[23] U.S. Department of Labor, Employee Benefits Security Administration, *Temporary Enforcement Policy on Prohibited Transactions Rules Applicable to Investment Advice Fiduciaries*, Field Assistance Bulletin No. 2018-02 (May 7, 2018), *available at* https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-02. The DOL went on to state that "investment advice fiduciaries may also choose to rely upon other available exemptions to the extent applicable after the Fifth Circuit's decision, but the Department will not treat an adviser's failure to rely upon such other exemptions as

resulting in a violation of the prohibited transaction rules if the adviser meets the terms of this enforcement policy."

[24] Chairman Jay Clayton, *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.

[25] Proposed Regulation Best Interest would not include an exemption for any subset of broker-dealers, including broker-dealers that are small entities.

[26] *See* proposed rule *§ 240.15l-1(a)(1).*

[27] Regulation Best Interest Release, at 46.

[28] The Investment Advisers Act does not expressly include a fiduciary duty. Instead, courts and the SEC have interpreted Section 206 of the Advisers Act to impose a fiduciary standard of conduct. *See, e.g., SEC v. Capital Gains*, *supra* note 8.

[29] *See* Section 29(a) of the Exchange Act.

[30] *See, e.g.*, FINRA Regulatory Notice 12-25 at Q2 and Q3 (regarding the scope of "recommendation"); *see also Michael F. Siegel*, Exchange Act Release No. 58737, at *21-27 (Oct. 6, 2008) (Commission opinion, sustaining NASD findings) (applying FINRA's guiding principles to determine that a recommendation was made), ***aff'd in relevant part***, *Siegel v. SEC*, 592 F.3d 147 (D.C. Cir. 2010), *cert. denied*, 560 U.S. 926 (2010); *In re Application of Paul C. Kettler*, Exchange Act Release No. 31354 at 5, n.11 (Oct. 26, 1992). Some commenters agreed that the Commission should use FINRA's definition and guidance of recommendation in establishing a standard of conduct for broker-dealers. *See* AFL-CIO Letter ("Because DOL relied on FINRA guidance with regard to what constitutes a recommendation, the SEC could simply adopt that same definition for its own rulemaking purposes"); Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America (Sept. 14, 2017) ("CFA") ("While the determination of whether a recommendation has been made will always be based on the particular facts and circumstances, FINRA guidelines provide a sound basis for such a definition."). *See also* Business Conduct Standards Adopting Release.

[31] This approach is consistent among FINRA and the DOL Fiduciary Rule.

See FINRA Notice to Members 01-23, Online Suitability (Mar. 19, 2001), and Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook, Exchange Act Release No. 62718 (Aug. 13, 2010), 75 FR 51310 (Aug. 19, 2010), as amended, Exchange Act Release No. 62718A (Aug. 20, 2010), 75 FR 52562 (Aug. 26, 2010) (discussing what it means to make a "recommendation"); FINRA Regulatory Notice 11-02, Know Your Customer and Suitability (Jan. 2011) (discussing how to determine the existence of a recommendation), and FINRA Regulatory Notice 12-25 at n.24 (citing FINRA Regulatory Notices discussing principles on determining whether a communication is a "recommendation"). *See also Michael F. Siegel*, Exchange Act Release No. 58737, at *11 (Oct. 6, 2008) (Commission opinion, sustaining NASD findings) (applying FINRA principles to facts of case to find a recommendation), ***aff'd in relevant part***, *Siegel v. SEC*, 592 F.3d 147 (D.C. Cir. 2010), *cert. denied*, 560 U.S. 926 (2010).

[32] *See, e.g.*, FINRA Regulatory Notice 12-25 at Q3 (regarding the scope of "implicit recommendation"); *see also infra* Section II. F for further discussion.

[33] Regulation Best Interest Release, at 86.

[34] *See* Section III of the Memorandum. Form CRS would require a brief and general description of the types of fees and expenses that retail investors will pay, under the Disclosure Obligation broker-dealers can build upon Form CRS to provide more specific fee disclosures relevant to the recommendation to the retail customer and the particular brokerage account for which recommendations are made. In addition, while Form CRS would require a high-level description

of specified conflicts of interest, the Disclosure Obligation would require more comprehensive disclosure.

[35] A stand-alone broker-dealer will be deemed to have reasonably disclosed the capacity in which it is acting at the time of the recommendation if the broker-dealer has already delivered to the retail customer the Form CRS and Regulatory Status Disclosure as outlined in Section III of this Memorandum. However, dual-registrants will not be considered to have reasonably disclosed the capacity in which it is acting at the time of the recommendation even if it has already delivered to the retail customer the Form CRS and Regulatory Status Disclosure, as neither disclosure would provide any greater clarity about the capacity in which the dual-registrant is acting in the context of the particular recommendation.

[36] *See, e.g., De Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F.3d 1293 (2d Cir. 2002) ("On a transaction-by-transaction basis, the broker… is obliged to give honest and complete information when recommending a purchase or sale."); *see also Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *SEC*, 174 F.2d 969 (D.C. Cir. 1949) (finding duty to disclose material facts "in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent").

The SEC notes that disclosure should be concise, clear and understandable; should apply plain English principles; and should avoid legal jargon, highly technical business terms or multiple negatives. The use of graphics would be permitted.

Further, disclosures must be true and may not omit any material facts necessary to make the required disclosures not misleading. As noted, proposed Regulation Best Interest applies in addition to any obligations under the Exchange Act, along with any rules the SEC may adopt thereunder, and any other applicable provisions of the federal securities laws and related rules and regulations. For example, any transactions or series of transactions, whether or not subject to the provisions of Regulation Best Interest, remain subject to the antifraud and anti-manipulation provisions of the securities laws, including, without limitation, Section 17(a) of the Securities Act [15 U.S.C. 77q(a)] and Sections 9, 10(b), and 15(c) of the Exchange Act [15 U.S.C. 78i, 78j(b), and 78o(c)] and the rules thereunder.

[37] Pursuant to the fiduciary duty under Sections 206(1) and (2) of the Advisers Act, an investment adviser must eliminate, or at least disclose, all conflicts of interest. However, as this duty is derived from the antifraud provisions, strict liability does not apply. In particular, scienter is required to establish violations of Section 206(1) of the Advisers Act, but a showing of negligence is adequate (*i.e.*, scienter is not required) to establish a violation of Section 206(2). The DOL Fiduciary Rule also avoids strict liability through the "good faith" exemption in its BIC Exemption.

[38] The BIC Exemption's "best interest" Impartial Conduct Standard would require that advice be in a retirement investor's best interest of a retirement investor, and further defines advice to be in the "best interest" if the person providing the advice acts "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with the such matters would use…without regard to the financial or other interests" of the person. BIC Exemption Release, 81 FR at 21007, 21027; BIC Exemption Section II(c)(1); Section VIII(d).

[39] *See* FINRA Rule 2111.05 (Suitability).

[40] In the Regulation Best Interest Release, the SEC notes that the term "prudence" is not a term frequently used in the federal securities laws; however, the SEC believes that this term conveys the fundamental importance of conducting a proper evaluation of any securities recommendation in accordance with an objective standard of care.

[41] *See*, *e.g.*, 15 U.S. Code § 77q; 17 CFR 240.10b-5.

[42] *See Certain Broker-Dealers Deemed Not to be Investment Advisers*, Advisers Act Release No. 2340 (Jan. 6, 2005); *Certain Broker-Dealers Deemed Not to be Investment Advisers*, Advisers Act Release No. 2376 (Apr. 12, 2005).

[43] Investment Advisers Release, at 5.

[44] Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) ("Investment Advisers Act Release No. 3060") (adopting amendments to Form ADV and stating that "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 Proxy Voting by Investment Advisers, Investment Advisers Act Release 2106 (Jan. 31, 2003)); *SEC* v. *Tambone*, 550 F.3d 106, 146 (1st Cir. 2008) ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund and its investors."); *SEC* v. *Moran*, 944 F. Supp. 286 (S.D.N.Y. 1996) ("Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients.").

[45] Investment Advisers Release, at 8.

[46] *See SEC* v. *Capital Gains*, *supra* note 8.

[47] See *In the matter of Joan Conan,* Investment Advisers Act, Release No. 1446 (Sept. 30, 1994) (citing Restatement (Second) of Agency § 393 cmt. a (incorporating by reference *id*. § 390 cmt. a)) (an investment adviser "violates no duty to the [client] by acting for his own benefit if he makes a full disclosure of the facts to an acquiescent [client] and takes no unfair advantage of him."); *SEC* v. *Capital Gains*, *supra* note 8, at 191-92 (the Advisers Act "reflects… a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.").

[48] Investment Advisers Release, at 21.

[49] *See* supra note 28.

[50] *See* Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2106 (Jan. 31, 2003) ("Investment Advisers Act Release No. 2106") (stating that under the Advisers Act, "an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting," which is the subject of the release, and citing *SEC* v. *Capital Gains*, *supra* note 8, to support this point). *See also* Restatement (Third) of Agency, § 8.08 (discussing the duty of care that an agent owes its principal as a matter of common law); Tamar Frankel, Arthur Laby & Ann Schwing, The Regulation of Money Managers, (updated 2017) ("Advice can be divided into three stages. The first determines the needs of the particular client. The second determines the portfolio strategy that would lead to meeting the client's needs. The third relates to the choice of securities that the portfolio would contain. The duty of care relates to each of the stages and depends on the depth or extent of the advisers' obligation towards their clients.").

[51] An adviser would not be expected to update a client's investment profile for a one-time financial plan or other investment advice that is not provided on an ongoing basis. *See* Investment Advisers Release, at 10.

[52] Investment Advisers Release, at 12.

[53] *See*, *e.g.*, Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) (stating "as a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information").

[54] Investment Advisers Release, at 11.

[55] *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006) (stating that investment advisers have "best execution obligations"); Investment Advisers Act Release No. 3060, *supra* note 44 (discussing an adviser's best-execution obligations in the context of directed brokerage arrangements and disclosure of soft dollar practices). *See also* Advisers Act rule 206(3)-2(c) (referring to adviser's duty of best execution of client transactions).

[56] Investment Advisers Release, at 14.

[57] *See SEC* v. *Capital Gains*, *supra* note 8 (describing advisers' "basic function" as "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments").

[58] *See* Investment Advisers Act Release No. 3060, *supra* note 44; *see also* 913 Study, *supra* note 11.

[59] Investment Advisers Release, at 15.

[60] *See* Investment Advisers Act Release No. 3060, *supra* note 44 (stating that "as a fiduciary, an adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship"). *See also* General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your *clients* of all material facts relating to the advisory relationship.") (emphasis in original).

[61] *See SEC* v. *Capital Gains*, *supra* note 8 (citing ethical standards of one of the leading investment counsel associations, which provided that an investment counsel should remain "as free as humanly possible from the subtle influence of prejudice, conscious or unconscious" and "avoid any affiliation, or any act which subjects his position to challenge in this respect").

[62] Investment Advisers Release, at 18.

[63] *Id*., at 19.

[64] *Id.*, at 23.

[65] The SEC bases its concern on the findings of various studies, *e.g.*, 913 Study, *supra* note 11. *See also* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, *et al.*, (Sept. 15, 2010) (submitting the results of a national opinion survey regarding U.S. investors and the fiduciary standard conducted by ORC/Infogroup for the Consumer Federation of America, AARP, the North American Securities Administrators Association, the Certified Financial Planner Board of Standards, Inc., the Investment Adviser Association, the Financial Planning Association and the National Association of Personal Financial Advisors); Siegel & Gale, LLC/Gelb Consulting Group, Inc., Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures (Mar. 5, 2005), *available at* http://www.sec.gov/rules/proposed/s72599/focusgrp031005.pdf ("Siegel & Gale Study"); Angela A. Hung, *et al.*, RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2008), *available at* https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf ("RAND Study").

[66] Relationship Summary Release, at 16.

[67] The proposed rule requires firms to use "plain language" in their Form CRS and explicitly prohibits the use of legal jargon, highly technical business terms or multiple negatives. Further, a strict four-page limit (or equivalent limit if in electronic form) would be mandated with firms prohibited from including any information other than what the instructions and the applicable item require or permit. The SEC is encouraging the use of methods such as embedded hyperlinks to direct retail investors to additional disclosures. Relationship Summary Release, at 18-19, 21.

[68] The SEC notes that these mock-ups do not provide a safe harbor and, depending on the circumstances of a particular firm, a Form CRS that merely copies the mock-ups may not provide

sufficient or accurate information about the firm, including for purposes of meeting the firm's obligations under the antifraud provisions of the federal securities laws. Relationship Summary Release, at 17.

[69] Advisers Act proposed rule 204-2(a)(14)(i); Exchange Act proposed rules 17a-3(a)(24) and 17a-4(e)(10).

[70] *See* Advisers Act rule 204-2(e)(1); and Exchange Act rule 17a-4(e)(10). Pursuant to Advisers Act rule 204-2(e)(1), investment advisers will be required to maintain the relationship summary for a period of five years, while Exchange Act proposed rule 17a-4(e)(10) would require broker-dealers to maintain the relationship summary for a period of six years.

[71] *See* Advisers Act rule 204-2(g)(2); and Exchange Act rule 17a-4(j).

[72] Siegel & Gale Study, *supra* note 65; RAND Study, *supra* note 65.

[73] Relationship Summary Release, at 163.

[74] *Id*., at 182.

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Annex A: Hypothetical Relationship Summaries Prepared by SEC Staff

The SEC has prepared three sample Relationship Summaries:

- Form CRS for broker-dealers
- Form CRS for investment advisers
- Form CRS dual-registrants