# SEC Fiduciary Rule Initiative

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# HISTORICAL DISTINCTION BETWEEN ADVISERS AND BROKER-DEALERS

- In the aftermath of the Great Depression, the U.S. securities industry was reorganized and regulated based on a fundamental premise that broker-dealers and investment advisers conducted distinct activities
  - Broker-dealers traditionally charge a commission for each transaction
  - Investment advisers traditionally charge a fee calculated as a percentage of assets under management
- Broker-dealers and investment advisers are generally subject to different regulatory regimes and standards of conduct:
  - Broker-dealers are subject to the Securities Exchange Act of 1934 and implementing regulations.
    - Transaction-specific duty to recommend products or investment programs that are "suitable" to clients
    - No fiduciary duty *per se,* but broker-dealers have duties to observe just and equitable principles of trade in the conduct of business
  - Investment advisers are subject to the Investment Advisers Act of 1940 and implementing regulations
    - Ongoing fiduciary duty to give investment advice that is "suitable" to clients
    - Ongoing fiduciary duty to act solely in the best interests of the client

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# BLURRING OF THE LINES

- By the 1990s, the brokerage industry was offering “fee-based” brokerage accounts, through which clients have access to a variety of brokerage services in exchange for a flat fee or a fee calculated as a percentage of a client’s assets
- In 1994, SEC Chairman Arthur Leavitt commissioned a committee of industry leaders to study broker-dealer compensation practices and conflicts of interest. The committee’s final report became known as the “Tully Report.” One of these best practices identified in the report was to base compensation on “client assets in an account, regardless of transaction activity, so the [broker-dealer would] receive some compensation even if they advise a client to ‘do nothing.’” The Tully Report also emphasized the importance of broker-dealers providing “investment counsel to individual clients.”
- Through the 1990s, it became increasingly common for broker-dealers to market themselves as “financial advisors,” rather than as stockbrokers, dealers, or salespersons
- In 2005, the SEC adopted a final version of Rule 202(a)(11)-1, which excluded from regulation under the Advisers Act fee-based programs for advice given by a broker-dealer in connection with non-discretionary accounts
- Following a lawsuit by the Financial Planning Association, the DC Circuit Court of Appeals in 2007 found that the SEC exceeded its authority by excluding broker-dealers that receive special compensation for advisory services and vacated Rule 202(a)(11)-1

# BLURRING OF THE LINES *(CONTINUED)*

- Numerous reports commissioned by the SEC and certain consumer organizations have confirmed that investors have difficulty distinguishing among industry professionals and the various titles, duties, and fees
  - In 2011, the SEC released a report on broker-dealers and investment advisers, as required by the Dodd-Frank Act. In the report, the SEC staff notes that investors are confused and generally not aware of differences between broker-dealers and investment advisers or their legal implications. The SEC staff further recommended a single standard of care applicable to both broker-dealers and investment advisers, while still permitting broker-dealers to receive transaction-based commissions
- In 2016, the DOL finalized its fiduciary rule
- In 2017, the Consumer Federation of America reported a study confirming that broker-dealers continue to market their services in a way that makes them sound as if they are investment advisers and have a fiduciary duty to clients. They refer to themselves as “financial advisors,” describe their services as “advice” or “planning,” and promote their services with messages designed to convince investors that they will be looking out for the investors’ best interests

# SEC FIDUCIARY RULE INITIATIVE

- Recognizing that the DOL's fiduciary rule may have significant effects on retail investors and entities regulated by the SEC, the SEC is examining the standards of conduct applicable to investment advisers and broker-dealers
- SEC Chairman Jay Clayton has indicated that he is working with DOL Secretary Alexander Acosta to propose a harmonized fiduciary rule
- A harmonized DOL and SEC fiduciary rule would be designed to avoid negative consequences resulting from differing standards of conduct under current DOL and SEC rules.
- Chairman Clayton believes that clarity and consistency — and, in areas overseen by more than one regulatory body, coordination — are key elements of effective oversight and regulation

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# SEC FIDUCIARY RULE INITIATIVE *(CONTINUED)*

- The SEC is considering a range of regulatory actions in connection with its fiduciary rule initiative:
  - maintain the existing regulatory structure
  - require enhanced disclosures intended to mitigate reported investor confusion
  - develop a best interests standard of conduct for broker-dealers
  - pursue a single standard of conduct combined with a harmonization of other rules and regulations applicable to both investment advisers and broker-dealers when they provide advice to retail investors
- On June 1, 2017, Chairman Clayton issued a request for public comment regarding the standards of conduct for investment advisers and broker-dealers that fall under the SEC's purview
  - The SEC has received over 150 comments in response to its request
  - The Investment Advisers Association asked the SEC to preserve the current standards for advisers and apply a "best interest" standard to broker-dealers "that is no less stringent than the Advisers Act fiduciary standard and that similarly encompasses the overarching principles of loyalty and care"
  - The Alliance for Retired Americans' comment cautioned against adopting a best interest standard that is "virtually indistinguishable from the existing suitability standard."

# SEC FIDUCIARY RULE INITIATIVE *(CONTINUED)*

- On October 4, 2017, in his remarks to the House of Representatives Committee on Financial Services, Chairman Clayton detailed four considerations that he believes should be addressed by any joint rulemaking introduced by the SEC, DOL and other regulators:
  1) Investors must have **choice** (*i.e.,* investors should not be “pushed into a narrow set of circumstances”)
  2) The rulemaking should provide **clarity** so “that investors know what type of person they’re dealing with and they know the obligations owed to them”
  3) The rulemaking should provide **consistency** (*i.e.,* “If you have two different types of accounts but you’re facing the same person — a retirement account and a non-retirement account — there ought to be consistency with respect to those accounts”
  4) The SEC, DOL and state regulators should be **coordinated** in how they approach fiduciary regulation
- During his remarks, Chairman Clayton declined to specify a timeframe for any proposed rulemaking, but indicated that the SEC fiduciary rule initiative is a priority

# LEGISLATIVE DEVELOPMENTS

- On October 12, 2017, the House Committee on Financial Services approved a bill that would repeal the DOL's fiduciary rule and impose a "best interest" standard of conduct on broker-dealers and their registered representatives when making investment recommendations to retail customers

# QUESTIONS?

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# Questions?

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