

The logo for K&L GATES is displayed in white, bold, sans-serif capital letters on a dark blue rectangular background. The background of the entire slide features a complex financial data visualization with a world map, various line and bar charts, and scattered numerical values in shades of blue and white.

K&L GATES

Session VI

Investment Adviser and Broker-Dealer Standards of Conduct

Richard F. Kerr, Partner, K&L Gates LLP

Pablo J. Man, Partner, K&L Gates LLP

SEC ADOPTS RULES AND INTERPRETATIONS RELATED TO IA AND BD STANDARDS OF CONDUCT

- On June 5, 2019, the SEC formally adopted four measures for the protection of retail investors.
 - Regulation BI (“Best Interest”).
 - Form CRS (“Customer Relationship Summary”).
 - Interpretation of investment advisers’ fiduciary duties.
 - Interpretation of the “solely incidental” prong of the broker-dealer exclusion from definition of “investment adviser.”
- Compliance Dates:
 - Regulation BI and Form CRS: June 30, 2020.
 - Interpretations reflect restatements of existing SEC views, and were effective July 12, 2019 on publication in the Federal Register.



GENERAL OBLIGATIONS OF REGULATION BI

- Broker-dealers and their natural person APs, when recommending securities and investment strategies to a retail customer, must act in the “best interest” of the customer, and not place their own interest ahead.
 - “Retail customer” = a natural person (or legal representative) who receives and uses a recommendation primarily for personal, family, or household purposes.
 - No exceptions based on wealth, experience, etc.
 - “Recommendation” = not defined but derived from current principles. “A call to action.”
 - Includes account recommendations, such as recommendations to roll over / transfer assets from one account to another, IRAs, retirement annuities, education accounts, etc.



GENERAL OBLIGATION IS MET BY SATISFYING FOUR KEY OBLIGATIONS

1. Disclosure Obligation

- Capacity
- Fees & Costs
- Type & scope of services
- Limitations on recommendations

2. Care Obligation

- Reasonable-basis (what I call “Know Your Security”)
- Best interest of the particular customer based on the customer’s profile
- Series of recommendations

3. Conflict of Interest Obligation

- Identify & eliminate
- Identify, mitigate & disclose

4. Compliance Obligation

- Policies & procedures
- Supervisory program



DOES REG BI APPLY?

Whether Reg BI applies to your firm depends on:

- 1) Whether the firm makes recommendations; and
- 2) Whether the recommendations are made to retail customers.

Consider different types of firms:

- Retail brokerage
- Execution-only
- Alternative Trading Systems
- Clearing Firms
- Institutional-only business
- Mutual fund principal underwriter
- Placement Agent
- Financial Planning
- Funding Portal
- Research provider



FORM CRS

- Investment advisers and broker-dealers will be required to provide relationship summaries on Form CRS to retail investors, and to post Form CRS on websites.
 - Firms will have to file Form CRS with the SEC through Web CRD or IARD (both if dually registered).
 - Forms must be updated within 30 days of information becoming outdated or inaccurate. Must communicate changes to investors within 60 days.
 - Forms will be in a uniform, machine-readable format in order to assist with comparisons.



FORM CRS

- Forms must include descriptions of services, standards of conduct, summaries of conflicts, and discussions of fees.
 - Must list examples of the most common fees and costs applicable to retail investors (e.g., custody, account maintenance, fees related to mutual funds and variable annuities, and other transactional / product-level fees).
 - Form CRS is required for all broker-dealers and investment advisers who provide services to retail customers, regardless of whether they provide recommendations



INVESTMENT ADVISER FIDUCIARY STANDARD INTERPRETATION

- Reaffirms an investment adviser's non-waivable fiduciary duty to clients
 - Clarifies that with full and fair disclosure, investment advisers and their clients are free to negotiate individualized terms which may shape the scope of the fiduciary duty
 - Clarifies that the fiduciary duty is comprised of a duty of care and duty of loyalty and provides the SEC's views as to the elements of such duties
 - Provides guidance as to how the duty may be applied different in the context of retail customers and institutional customers
- Clarifies SEC's views with respect to the use of hedge clauses in investment advisory agreement
 - Heitman no-action letter withdrawn



SOLELY INCIDENTAL INTERPRETATION

- Solely Incidental Interpretation.
 - A broker-dealer whose advisory services are “solely incidental” to its broker-dealer business and that does not receive special compensation is not deemed to be an investment adviser.
 - Account discretion that is limited in time, scope, or other manner (time / price discretion, infrequent or isolated discretion, or discretion to purchase any bond with a specified credit rating and maturity) and not comprehensive and continuous would be “solely incidental.”
 - Account monitoring would not automatically fail the “solely incidental” prong, but agreements to monitor would result in a recommendation to buy, sell, or hold each time monitoring occurs and would be covered by Regulation BI. Consider account monitoring policies and procedures that are tailored to registration status of personnel.



K&L GATES