

[Securities Regulation Daily Wrap Up, TOP STORY—SEC proposes ‘best interest’ standard for BDs, limits on the use of the term ‘adviser’, \(Apr. 18, 2018\)](#)

Securities Regulation Daily Wrap Up

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Nearly eight years after the Dodd-Frank Act gave the SEC authority to commence rulemaking on the topic, the Commission has proposed a package of rules concerning the standards of care applicable to investment advice given by broker-dealers and investment advisers. By a four-to-one vote, the Commission approved the release for public comment of three proposals, the first of which would impose an enhanced "best interest" standard of conduct on broker-dealers and associated persons when recommending securities transactions to retail customers. The second proposal would place new restrictions on the use of the term "adviser" or "advisor" by broker-dealers, while requiring both brokers and advisers to provide a brief relationship summary to retail investors on new Form CRS. The third proposal would mandate an interpretation by the Commission of the standard of conduct for investment advisers.

Although Commissioners Jackson, Peirce, and Piwowar each raised concerns about various aspects of the proposals, they joined Chairman Jay Clayton in voting in favor of the releasing the proposals for comment; Commissioner Stein voted against. The comment period will be open for 90 days. The full text of the lengthy proposal, which the commissioners noted exceeded 1,000 pages, had not yet been released by the SEC at the time of publication.

The SEC's proposals come slightly over a month after the Fifth Circuit Court of Appeals [vacated](#) in its entirety the Department of Labor's controversial "fiduciary rule," which expanded the definition of "investment advice fiduciary" under ERISA to encompass retirement advice given by broker-dealers. Under the DOL's fiduciary rule, broker-dealers that make recommendations to ERISA accounts are now likely to be held to a fiduciary standard of care absent reliance on specific exceptions. Although the final rule was adopted in 2016 after undergoing six years of development, President Trump mandated that the DOL reexamine the fiduciary rule shortly after he took office, and the agency subsequently [delayed imposition](#) of the full terms of the rule until July 1, 2019. The DOL has until April 30 to seek review of the Fifth Circuit's decision.

Regulation Best Interest. Under proposed Regulation Best Interest, broker-dealers making recommendations to retail customers would have a duty to act in the best interest of the customer at the time the recommendation is made, without putting the financial or other interest of the broker-dealer ahead of the retail customer. A broker-dealer would have three specific obligations in order to discharge this duty under the rule:

1. **Disclosure:** The broker-dealer must disclose to the retail customer the key facts about the relationship, including material conflicts of interest.
2. **Care:** The broker-dealer must exercise reasonable diligence, care, skill, and prudence to (a) understand the product; (b) have a reasonable basis to believe that the product is in the retail customer's best interest; and (c) have a reasonable basis to believe that a series of transactions is in the retail customer's best interest.
3. **Conflicts of interest obligation:** The broker-dealer must have and enforce policies and procedures reasonably designed to identify and then disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives; other material conflicts of interest must be at least disclosed.

Form CRS. The second proposal would require investment advisers, broker-dealers, and their associated persons to provide retail investors with a standardized relationship summary on new Form CRS. The summary

would be limited to a maximum of four pages and would disclose the material terms of the investment relationship, including key differences in the principal types of services offered, the legal standards of conduct that apply to each, the fees a customer might pay, and certain conflicts of interest.

In order to avoid misleading customers, broker-dealers and associated persons would be restricted from using the terms "adviser" and "advisor" unless they hold the appropriate registrations. Investment advisers and broker-dealers would be required to communicate directly and clearly their registration status to investors and prospective investors.

Interpretation of fiduciary standard for advisers. The third proposal would result in the issuance of an interpretation by the SEC concerning certain aspects of the fiduciary duty that an investment adviser owes to its clients. The interpretation would reaffirm and clarify the fiduciary duty based on common law and equitable principles that the Supreme Court found exists within the Advisers Act.

Clayton statement. In his [opening remarks](#), Chairman Clayton described the rulemaking package as representing a "significant step" in framing the issues and proposing a comprehensive path forward with regard to the standards of conduct for investment professionals. Clayton noted that these issues affect the estimated 43 million American households that have a retirement or brokerage account as well as the approximately 940,000 women and men in the securities industry. He said that the proposals reflect the Commission's efforts to fill the gaps between reasonable investor expectations and legal requirements, while preserving investor access and investor choice.

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