

## [Securities Regulation Daily Wrap Up, TOP STORY—SEC adopts Regulation BI, Form CRS summary, and related interpretations, \(Jun. 5, 2019\)](#)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [John Filar Atwood](#)

With Commissioner Jackson dissenting, Commission approves new standard of conduct for broker-dealers, and requirement for brokers and advisers to disclose a relationship summary to retail investors.

After grappling for nearly 20 years with the development of new standards of conduct for financial professionals, the SEC voted today to adopt Regulation BI, a new standard for broker-dealers when making a recommendation to a retail customer. The controversial proposal elicited a large number of comments, and Chairman Jay Clayton [said](#) that the extensive feedback, along with regulatory developments since the proposal, solidified his view that the Commission proposed the right framework for the regulation of personalized investment advice.

Regulation BI was part of a package of reforms approved today. The Commission also adopted a new Form CRS relationship summary, as well as an interpretation reaffirming the fiduciary duty investment advisers owe to clients under the Investment Advisers Act. It also voted to issue an interpretation of the "solely incidental" prong of the broker-dealer exclusion under Investment Advisers Act Section 202(a)(11)(C).

The moves were not without their detractors at the SEC, including Commissioner Robert Jackson who was the [dissenter](#) in the Commission's 3 to 1 vote. In addition, SEC Investor Advocate Rick Fleming released a [statement](#) calling Regulation BI "a step in the right direction," but adding that it is undermined by the Commission's interpretation of the fiduciary duty that applies to investment advisers.

Clayton addressed several potential criticisms of the SEC's decisions, including that new Regulation BI does not enhance the standard of conduct beyond what currently exists. He disagreed, noting that the new regulation carries a four-pronged test and can no longer be met by disclosure alone. Some observers will say that the relationship summary required by Form CRS will confuse investors, he stated. In his view, it will not and the criticism misses the point of the significant improvements in disclosure embedded in the relationship summary.

The SEC [said](#) that the package of rulemakings and interpretations is designed to enhance retail investors' relationships with investment advisers and broker-dealers, bringing the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access to a variety of investment services and products. Specifically, the actions are intended to help retail investors better understand and compare the services offered and foster greater consistency in the level of protections provided, particularly at the point in time that a recommendation is made.

**Regulation BI.** Regulation BI states that when making a recommendation of a securities transaction or an investment strategy involving securities, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. In an enhancement from the original proposal, Regulation BI applies to account recommendations, including recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA, and recommendations to take a plan distribution. It also applies to implicit "recommendations to hold" that result from agreed-upon account monitoring.

Regulation BI includes specific obligations in the areas of disclosure, care, conflicts of interest, and compliance. The disclosure obligation holds that broker-dealers must disclose material facts about the relationship and recommendations, including specific disclosures about the capacity in which the broker is acting, fees, the type and scope of services provided, conflicts, limitations on services and products, and whether the broker-dealer provides monitoring services.

Under the care obligation, a broker-dealer must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer. A broker-dealer must understand potential risks, rewards, and costs associated with the recommendation, and must consider these in light of the customer's investment profile. The Commission adjusted the original proposal to explicitly require a broker-dealer to consider the costs of the recommendation.

With respect to conflicts of interest, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate conflicts of interest. In another change to the original proposal, the final regulation requires policies and procedures to: (1) mitigate conflicts that create an incentive for the firm's financial professionals to place their interest or the interests of the firm ahead of the retail customer's interest; (2) prevent material limitations on offerings, such as a limited product menu or offering only proprietary products, from causing the firm or its financial professional to place his or her interest or the interests of the firm ahead of the retail customer's interest; and (3) eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

The compliance obligation of Regulation BI also was added in response to feedback on the original proposal. It requires broker-dealers to establish, maintain, and enforce policies and procedures reasonably designed to achieve compliance with Regulation BI as a whole.

**Form CRS relationship summary.** The Commission voted to require investment advisers and broker-dealers to deliver a relationship summary to retail investors at the beginning of their relationship. The firms will have to summarize information about services, fees, and costs; conflicts of interest; legal standard of conduct; and whether or not the firm and its financial professionals have disciplinary history.

According to the SEC, the relationship summary will have a standardized question-and-answer format to promote comparison by retail investors in a way that is distinct from existing disclosures. It also will permit the use of layered disclosure so that investors can more easily access additional information from the firm about these topics. The summary also will need to highlight the Commission's investor education website, which includes a series of educational videos designed to provide investors with basic information about broker-dealers and investment advisers.

**Fiduciary duty interpretation.** The Commission agreed to issue an interpretation to reaffirm and, in some cases, clarify the Commission's views of the fiduciary duty that investment advisers owe to their clients under the Investment Advisers Act. The SEC noted that an investment adviser owes a fiduciary duty to its clients. The duty is principles-based and applies to the entire relationship between an investment adviser and its client. The SEC believes that by highlighting principles relevant to the fiduciary duty, investment advisers and their clients will have greater clarity about advisers' legal obligations.

**Solely incidental interpretation.** The broker-dealer exclusion under the Investment Advisers Act excludes from the definition of investment adviser a broker or dealer whose performance of advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation for those services. The interpretation will confirm and clarify the Commission's interpretation of the "solely incidental" prong of the broker-dealer exclusion of the Investment Advisers Act.

Specifically, the final interpretation will state that a broker-dealer's advice as to the value and characteristics of securities or as to the advisability of transacting in securities falls within the "solely incidental" prong of this exclusion if the advice is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions.

Jackson disagreed with the adoption of the reforms, stating that instead of requiring Wall Street to put investors first, the rules retain a "muddled standard that exposes millions of Americans to the costs of conflicted advice." Clayton asked whether he was suggesting that SEC staff was putting Wall Street over investors, and Jackson clarified that the legal standard was doing that and that he was not questioning the staff's motivations.

Jackson also took issue with the claim in the guidance that we "lack data to identify which... advisers currently understand their fiduciary duty to require something different" than the standard being adopted. He said that his office conducted a study of the text from more than half a million brochures that advisers have given to investors. It found that firms with 89 percent of assets under management told the American public that they put investor interests first.

Jackson said the study went on to show that advisers who use the language adopted in today's release are much more likely to offer conflicted advice. Clayton said that he would look at the report, but expressed his wish that Jackson had gotten it to him sooner.

Clayton concluded by asking Stephanie Avakian, co-director of the SEC's Division of Enforcement, whether any action the Commission was taking today would impede her ability to effectively enforce the securities laws. Avakian said no, adding that having some of the disclosure that will be required in Form CRS may make it easier for the staff to detect and enforce violations.

MainStory: TopStory FiduciaryDuties BrokerDealers InvestmentAdvisers FinancialIntermediaries Enforcement