



**Morgan Lewis**

**SEC PROPOSED  
STANDARDS  
OF CONDUCT**

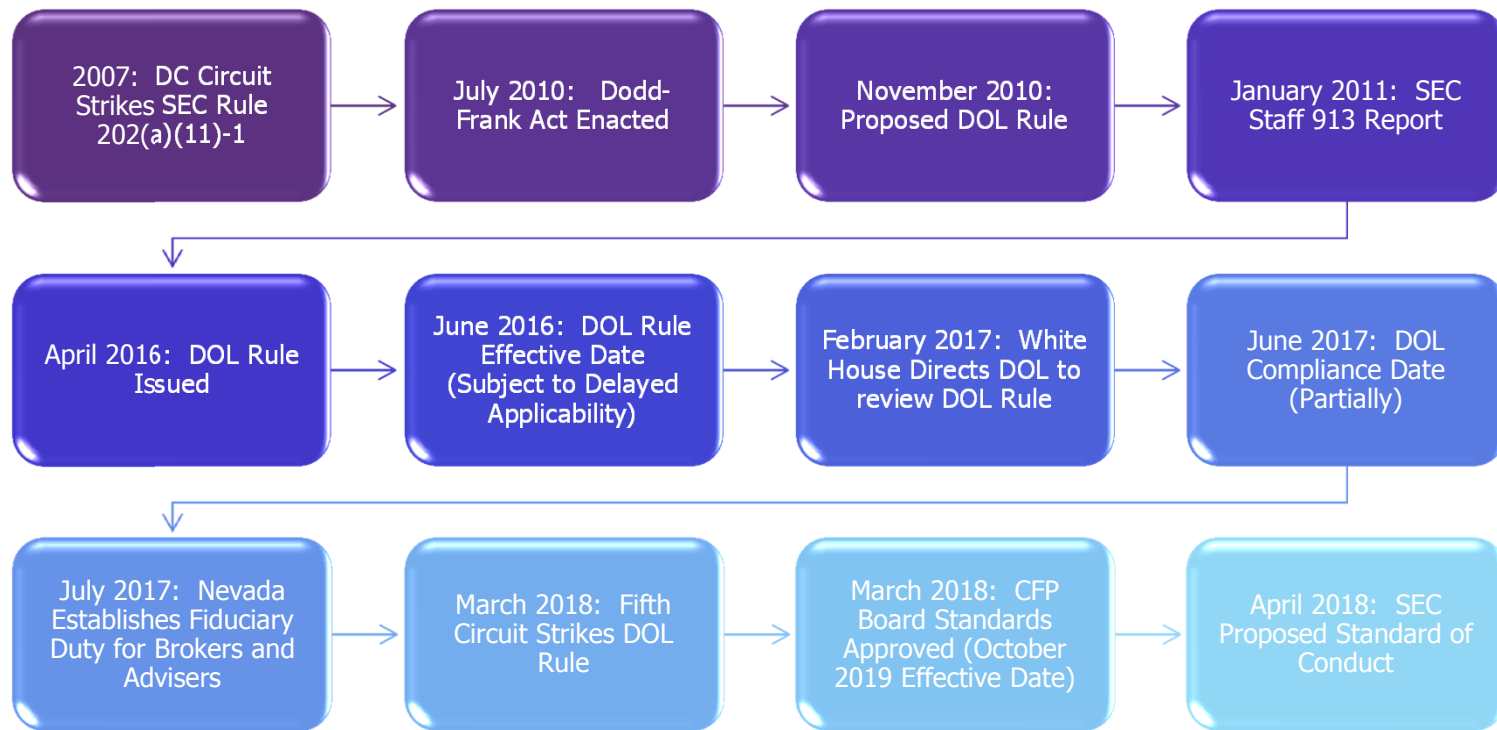
**FOR RETAIL ADVICE**

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May 9, 2018

# Overview

- Background
- Overview of the Proposals
  - Regulation Best Interest
  - Proposed Adviser Interpretation
  - Form CRS and Use of Labels
- Impact and Next Steps

# Background



# Background

- DOL Rule Fifth Circuit Decision (Mar. 15, 2018)
  - Federal court of appeals vacates DOL Rule, finding it to be “unreasonable” (case brought by US Chamber of Commerce, SIFMA, and other BD/insurance groups); DOL exceeded its statutory authority (2-1 decision)
  - “Rather than infringing on SEC turf, DOL ought to have deferred to Congress’s very specific Dodd-Frank delegations and conferred with and supported SEC practices to assist IRA and all other individual investors.”
  - DOL had 45 days (until May 7, 2018) to appeal decision to full Fifth Circuit panel and declined to do so
  - On May 7, 2018 the DOL published its Temporary Enforcement Policy
  - Still waiting on order from Fifth Circuit vacating the rule
- SEC Chairman Clayton states that 5<sup>th</sup> Circuit decision has not changed his intent of moving forward with fiduciary rule (“the sooner, the better”)
- SEC issues proposed standard of conduct for retail investors on April 18, 2018

# Overview of Proposed “Package”

## Regulation Best Interest

- Establishes a best interest obligation for broker-dealers providing advice to retail customers
- Satisfied through
  - Disclosure Obligation
  - Care Obligation
  - Conflicts of Interest Obligation

## Investment Adviser Interpretation

- Designed to clarify certain aspects of fiduciary duty under Section 206
- Duty of Care
  - Personalized advice that is suitable for and in the best interests of the client
  - Best execution
  - Ongoing advice and monitoring
- Duty of Loyalty
- Enhanced IA Regulation
  - Federal Licensing and Continuing Education
  - Account Statements
  - Financial Responsibility

## Form CRS

- Four-page disclosure document
- Delivered to retail investors before or at the time of entering into advisory contract or when retail investor first engages broker-dealer
- Separate disclosure requirements for broker-dealers, investment advisers, and dual registrants
- Restrictions on use of “adviser” and “advisor”
- Prominent disclosure of status as a registered broker-dealer or investment adviser in retail communications

# Regulation Best Interest

- Best Interest Obligation
  - When making a recommendation of any securities transaction or investment strategy involving securities, the broker-dealer and its registered representatives shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer or registered representative ahead of the interest of the retail customer.
- “Best interest” is not defined
- Designed to enhance standard for broker-dealers, but does not make it identical to that of investment advisers
- Obligation is triggered at the time of a recommendation, and there is no ongoing obligation
- Components:
  - Disclosure Obligation
  - Care Obligation
  - Conflicts of Interest Obligation

# Regulation Best Interest

- Disclosure Obligation
  - Prior to or at the time of the recommendation, the broker-dealer reasonably discloses material facts about the relationship in writing
    - Services, fees, and charges
    - Scope of relationship
    - Material conflicts of interest related to the recommendation
- Care Obligation
  - In making the recommendation, the broker-dealer exercises reasonable diligence, care, skill, and prudence
    - Reasonable-basis obligation
    - Customer-specific obligation
    - Quantitative obligation

# Regulation Best Interest

- Conflicts of Interest Obligation
  - 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
    - Identify and disclose and mitigate, or eliminate, material conflicts related to financial incentives



# Proposed Adviser Interpretation

- Fiduciary duty not specifically defined in the Advisers Act
- Duty of Care
  - Provide personalized advice that is suitable for and in the best interests of the client based on the client's investment profile and cost (fees and compensation)
  - Seek best execution
  - Provide advice and monitoring on an ongoing basis over course of relationship

# Proposed Adviser Interpretation

- Duty of Loyalty
  - Seek to avoid conflicts of interest with clients and, at a minimum, make full and fair disclosure to its clients of all material conflicts of interest
  - Clear and detailed enough for a client to make a reasonably informed decision
  - Disclosure of a conflict alone is not always sufficient to satisfy the duty of loyalty
    - Client did not understand the nature and import of the conflict
    - Material facts concerning the conflict could not be fully and fairly disclosed
    - Disclosure does not adequately convey the material facts or the nature, magnitude, and potential effect of the conflict
  - If disclosure is insufficient, adviser should eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed

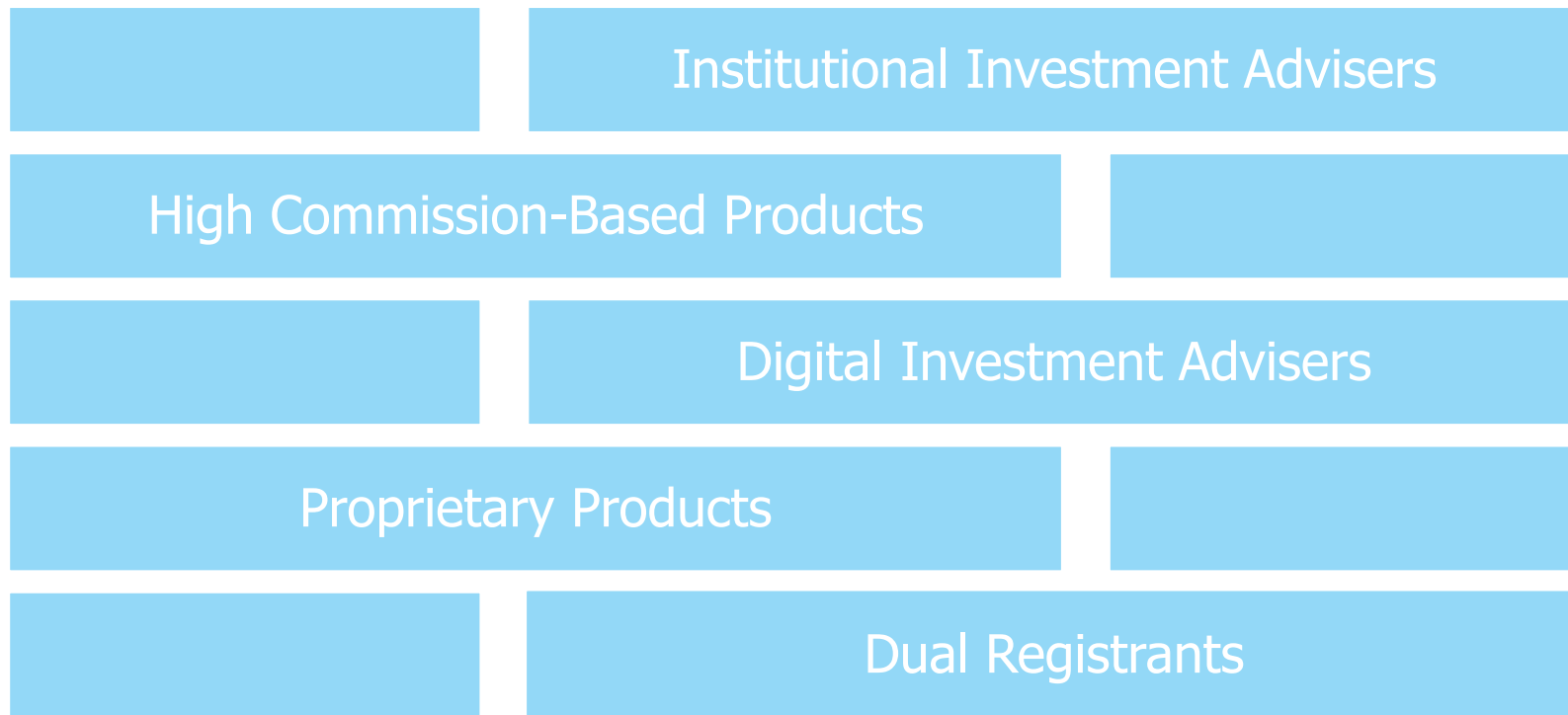
# Form CRS and Titles

- Four-page disclosure about services, fees, standard of conduct, and conflicts
- Separate disclosure requirements for broker-dealers, investment advisers, and dual registrants
- Delivery to “retail investors”
  - A prospective or existing client or customer who is a natural person (an individual), and legal representatives of such persons, regardless of net worth
  - Different from “retail customer” term used in Regulation BI
    - Receives a recommendation of any securities transaction or investment strategy involving securities
    - Uses recommendation primarily for personal, family, or household purposes
  - Disclosure focuses on an earlier stage in relationship, potentially before discussing investments

# Form CRS and Titles

- Titles
  - Broker-dealers and their registered representatives may not use the term “adviser” or “advisor” when communicating with retail investors unless:
    - Broker-dealer is registered as an investment adviser
    - Registered representative is a supervised person of an investment adviser and provides advice on behalf of the adviser
- Disclosure of Registration Status
  - Prominent disclosure of registration or affiliated-person status in print or electronic communications
  - For print, in body of communication and not in a footnote
  - For electronic, in a manner reasonably calculated to draw retail investor attention

# Impact and Next Steps



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Chris Cox advises global companies on strategic issues, corporate governance, securities regulation, and general business matters worldwide. He focuses on matters involving federal and state governments, cross-border investment, homeland security, and multistate litigation. During a 23-year Washington career, Chris was a White House counsel to President Ronald Reagan, chairman of the SEC, chairman of the Homeland Security Committee in the US House of Representatives, and the fifth-ranking elected leader in the House.

Prior to his Washington career, Chris was a partner in the corporate practice of another international law firm, where he was the head of the corporate department in Orange County and a member of the firm's national management. He also taught federal income tax as a member of the faculty at Harvard Business School.

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Jennifer Klass is a regulatory counseling lawyer with a broad background in investment management regulation. She advises clients on a wide range of investment advisory matters, including investment adviser registration and interpretive guidance, disclosure and internal controls, regulatory examinations, and enforcement actions. Her clients include major investment banks, investment advisers, broker-dealers, and the sponsors of private investment funds and mutual funds. Previously vice president and associate general counsel at Goldman, Sachs & Co., Jen's practice focuses on the convergence of investment advisory and brokerage services.

Advertising and communications with the public, social media, and fiduciary duty and disclosure are among the securities regulatory areas in which Jen counsels clients. She also advises them on investment adviser registration, internal controls, compliance policies and procedures, separately managed (or wrap fee) programs, regulatory examinations and enforcement actions, interpretive guidance, and no-action requests.

While at Goldman, Sachs, Jen counseled its private wealth management and asset management businesses. She was also previously an associate at Morgan Lewis.



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Steven W. Stone is a securities lawyer who counsels clients on regulations governing broker-dealers, investment advisers and bank fiduciaries, and pooled investment vehicles. Head of the firm's financial institutions practice, Steve counsels most of the largest and most prominent US broker-dealers, investment banks, investment advisers, and mutual fund organizations. He regularly represents clients before the SEC, both in seeking regulatory relief and assisting clients in enforcement or examination matters.

Steve advises major US broker-dealers in the private wealth and private client businesses that offer investment advice and brokerage services to high-net-worth clients, as well as broker-dealers serving self-directing clients. He also works as counsel on various matters to the Securities Industry and Financial Markets Association's (SIFMA's) private client committee and represents most of the best-known US broker-dealers in this area. He also advises broker-dealers and investment advisers in the managed account or wrap fee area, and serves as counsel to the Money Management Institute, the principal trade association focused on managed accounts. Steve also counsels various institutional investment advisers and banks on investment management issues, including conflicts, trading, disclosure, advertising, distribution, and other ongoing regulatory compliance matters.

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Brian J. Baltz focuses his practice on the regulation of investment advisers, broker-dealers, and bank fiduciaries. Brian advises clients offering investment advice and brokerage services through their private wealth and private client businesses on issues arising under regulation by the SEC, Financial Industry Regulatory Authority (FINRA), and Office of the Comptroller of the Currency (OCC). Brian advises investment advisers, broker-dealers, and banks on investment management issues, including conflicts, disclosure, trading, wrap fee programs, soft dollar arrangements, advertising, and other ongoing regulatory compliance matters.

Before joining Morgan Lewis, Brian held multiple positions in the Division of Trading and Markets of the SEC, including special counsel in the Office of Chief Counsel and special counsel in the SEC's Office of Market Supervision. While in the Office of Chief Counsel, he was part of the team responsible for drafting a proposed rule to establish a uniform standard of conduct for broker-dealers and investment advisers. Prior to his work at the SEC, Brian was public policy counsel to a financial services industry trade association based in Washington, DC, where he worked on legislative and regulatory issues impacting broker-dealers and investment advisers, including the Dodd-Frank Wall Street Reform and Consumer Protection Act.

## Our Global Reach

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North America

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# Morgan Lewis

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