



memorandum

ADVISORS' AND BROKERS' FIDUCIARY DUTY: THE SEC IS MAKING THE RULES NOW

DOL Fiduciary Rule – Dying on the Vine

On March 15, 2018, a federal court in New Orleans vacated the US Department of Labor's (DOL) fiduciary rule in its entirety, including the Best Interest Contract Exemption and other related exemptions. Under a federal law called the Administrative Procedures Act, the court's opinion will apply nationwide if the DOL does not file an appeal with the Supreme Court. [The DOL has until May 7th to request a rehearing with the court but did not do that.] While it is impossible for us to predict what will happen, we believe the DOL fiduciary rule is as good as dead. That doesn't mean you can ignore it, at least for now. The DOL has until June 13, 2018 to appeal to the Supreme Court. You may want to use this time to consider how you will operate going forward if the DOL rule is in fact vacated. If that happens, things could go back to the way they were before the DOL started to change the rules, at least with respect to the way ERISA defines who is a fiduciary. Many vendors, however, already have processes in place and may continue to comply with the rule voluntarily. Moreover, there are other laws that impact broker-dealers and advisors, including state and federal securities laws.

SEC Proposed Rules

The SEC has issued a comprehensive package of proposed rules that will affect broker-dealers and investment advisors. These rules are being hyped as the replacement for the DOL fiduciary rule. The SEC has issued three proposed rules: Regulation Best Interest, Form CRS Proposal, and a Proposed Investment Adviser Fiduciary Duty Interpretation. It could be a few years until the new SEC rules become effective, but it is worth reviewing them now.

Regulation Best Interest

Regulation Best Interest would establish a standard of conduct for broker dealers and individuals associated with broker-dealers. It would require those persons to act in the best interest of a retail customer when making a recommendation of a securities transaction or investment strategy involving securities. Broker-dealers would have three obligations when making a recommendation: a disclosure obligation, a care obligation, and a conflict-of-interest obligation.

Under the disclosure obligation, the broker-dealer would have to disclose to the retail investor key facts about the relationship, including material conflicts of interest. Under the care obligation, the broker-dealer would have to exercise reasonable diligence, care, skill, and prudence to understand the securities it recommends. The broker-dealer would also be required to have a reasonable basis to believe the securities product is in the retail investor's best interest. The broker-dealer must also have a reasonable basis to believe that the series of securities transactions are in the retail investor's best interest. Under the conflict of interest obligation, the broker-dealer would have to establish policies and procedures that are reasonably designed to identify and disclose conflicts of interest as well as other matters.

Form CRS Proposal

In the Form CRS Proposal, the SEC proposes to require broker-dealers and investment advisors to deliver to retail investors a customer or client relationship summary (Form CRS) that would explain general information about the retail investor's relationship with the advisor or broker-dealer. The CRS would be designed to help retail investors understand things like services, fees, conflicts, and disciplinary history of firms and financial professionals they are considering. The Form CRS Proposal would also prohibit broker-dealers and their associated financial professionals from using the term "adviser" or "advisor" unless such person is a registered investment advisor, is acting on behalf of a bank or insurance company, or acts on behalf of a municipal advisor or a commodity trading advisor. For investment advisors, Form CRS would be required by Form ADV Part 3. For broker-dealers, Form CRS would be required by a new rule. The Form CRS would not be more than four pages and could be provided digitally to retail investors.

Proposed Investment Adviser Fiduciary Duty Interpretation

The Proposed Investment Adviser Fiduciary Duty Interpretations describes the SEC's views on the scope of an investment advisor's standard of care under the Investment Advisers' Act of 1940. It is intended to address, reaffirm, and clarify certain aspects of the fiduciary duty that an investment advisor owes to its clients. It also seeks comments on whether there should be federal licensing, qualification, and continuing education requirements for investment advisor representatives, whether advisors should be required to furnish customers with account statements that explain the fees and expenses charged for advisory services, and whether advisors should be subject to the same financial responsibility requirements that apply to broker-dealers, such as capital requirements and the requirement to maintain a fidelity bond.

For more information, you can call Lee T. Jennings at (630) 802-7644.

Please visit our website at www.danaconsulting.com.