

The SEC's Fiduciary Rule Proposal — Implications for Investment Advisers (Part 2)

This post continues our [discussion](#) of the SEC's April 18, 2018, [fiduciary rulemaking proposal](#) (the "Proposal"). Here we address the [Proposed Interpretation Regarding Standard of Conduct for Investment Advisers and Request for Comment on Enhancing Investment Adviser Regulation portion of the Proposal](#) which would, in sum, (i) restate advisers' fiduciary duties under the Advisers Act and (ii) impose a variety of new requirements on advisers similar to those applicable to broker-dealers.

Investment Adviser Fiduciary Duties Restated

In its proposed interpretation, the SEC noted that it is not proposing a uniform standard for broker-dealers and investment advisers because they have different types of relationships and business models. According to the SEC, the proposed interpretation just "reaffirms, and in some cases, clarifies" the existing patchwork fiduciary standard currently expected under the Advisers Act, which stems from the law of agency. That standard, as long-agreed and as interpreted in the Proposal, includes a duty of loyalty and a duty of care. The proposed interpretation would explicitly add that the duty of loyalty requires an investment adviser to:

- put "client's interests first," ahead of its own, and
- not "unfairly favor" one client over another.

The proposed interpretation would also explicitly divide the duty of care into three separate responsibilities to:

- provide advice that is in clients' "best interests;"
- seek "best execution," or the most favorable transaction costs under the circumstances; and
- act and provide tailored advice/monitoring over the course of each client relationship that is in the "best interest" of the client and commensurate with the particulars of the relationship.

The proposed restated fiduciary duty, as noted by some SEC Commissioners during the open meeting, could perhaps be refined to define potentially ambiguous and subjective terms like "best interest." On conflicts of interest, though, the proposed interpretation would make clear that advisers must disclose and attempt to mitigate conflicts by providing clients with sufficient facts under the circumstances to make reasonably informed decisions before consenting to conflicts. The SEC noted that some conflicts may not be cured by disclosure, and that even with full and fair disclosure, an adviser must still act in the client's best interests. Thus, the SEC said, advisers cannot "disclose or negotiate away, and the investor cannot waive," the adviser's duty to place the client's interest ahead of its own.

Open Questions: Potential New Requirements for Licensing, Education, Client Communications and Capitalization

The proposed interpretation also requests comment on "enhancing" the regulation of advisers by including licensing, education, accounting, and minimal capital requirements comparable to those applicable to broker/dealers. A few of the many questions put forth in the Proposal are summarized below. *Investment Adviser Representative ("IAR") Licensing and Continuing Education Proposals* Under the Advisers Act there are

currently no licensing or qualification requirements for IARs as there are for broker-dealer representatives under the Exchange Act and FINRA. States may impose such requirements on IARs conducting business in the state. The SEC requests comment on whether there should be licensing and continuing education requirements for SEC-registered investment adviser personnel. Topics include:

- Which personnel should be covered?
- How should the education requirement be structured?
- How long should a license last?
- Should individuals register with the SEC on a form similar to [Form U-4](#)?

Client Account Statement Delivery Proposal The Advisers Act does not squarely require all advisers to provide account statements to client, although the Advisers Act [custody rule](#) requires that quarterly client account statements be delivered under certain circumstances as does [Rule 3a-4](#) under the Investment Company Act. The SEC requests comment on whether it should propose rules requiring advisers to provide regular client account statements. Questions include:

- To what extent do retail advisory clients already receive account statements?
- How often should clients receive account statements?
- How costly would it be to provide account statements?

Financial Responsibility Proposals Unlike [broker-dealers](#), investment advisers are generally not subject to net capital requirements. Under the Advisers Act, advisers must disclose any material financial condition that impairs their ability to service clients, but are not required to obtain insurance despite their frequent access to client assets. The SEC asks for comment on whether it should propose new rules requiring net or other minimum capital requirements for advisers, looking at questions such as:

- Do the Advisers Act adequately address the potential for misappropriation of client assets and other financial responsibility concerns for advisers?
- Should advisers be required to obtain a fidelity bond from an insurance company?
- Should advisers have to maintain a certain amount of capital?
- What would be the expected cost of either maintaining some form of reserve capital or purchasing a fidelity bond?
- Should adviser financials be subject to periodic audit requirements?

Part Three of this Blog

Stay tuned for Part 3 of this blog, where we will expand upon our discussion of proposed Form CRS "Relationship Summary" and the proposed amendments to Form ADV. With Part 4, our final post on the Proposal for now, we'll dive into Regulation Best Interest.

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