

The logo consists of the text "Fi360" centered within a white square border. The background of the entire image is a horizontal gradient from light orange on the left to dark red on the right.

Fi360

Reg BI Cometh!

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Topics

- Overview – the basic facts
- The four parts
 - Regulation Best Interest
 - Form CRS Relationship Summary
 - Interpretative guidance for RIAs on their fiduciary duty under the Advisers Act
 - Interpretative guidance on the broker-dealer exemption: “solely incidental”
- Closing Comments: What the rules package does and what to do about it

Overview – The Basics

- All four parts of the package passed on June 5, 2019 on a 3-1 vote; Commissioner Jackson (lone Democrat) dissenting on all parts
- Purpose: “to enhance the quality of retail investors’ relationships with broker-dealers and investment advisers” and “to enhance investor protections while preserving retail investor access and choice”
- Reg BI and Form CRS will become effective 60 days after publication in the Federal Register; enforcement date will be June 30, 2020
- The two new interpretations become effective upon publication in the Federal Register (which has not yet occurred)

Overview – Help for Firms and the Public

- To help firms with implementation, the SEC is establishing an inter-Divisional Standards of Conduct Implementation Committee
 - Division of Investment Management
 - Division of Trading and Markets
 - Division of Economic and Risk Analysis
 - Office of Compliance and Examinations
 - Office of the General Counsel
- New dedicated page on Investor.org, the SEC’s investor education website
 - Educational information about broker-dealers and investment advisers
 - A link to this page will be required on the Form CRS Relationship Summary
- SEC staff expected to publish FAQs

Reg BI – How it applies

- Broker-dealers (including affiliates on the BD) must act in the retail customer’s best interest when making a recommendation
- “Best interest” is not defined; broker-dealer must not place its own interests above the customer’s interests
- Applies to recommendations about:
 - Securities and investment strategies involving securities
 - Types of accounts (brokerage versus advisory)
 - Rollovers or transfers to IRAs
 - Whether to take plan distributions

Reg BI – Four Obligations

1. Disclosure Obligation:

- Before or at the time of a recommendation
- Material facts about the relationship and recommendations: capacity, fees, type and scope of services, conflicts, limitations on products and services, and whether monitoring services are included

2. Care Obligation:

- Exercise reasonable diligence, care and skill
- Understand potential risks, rewards, and costs
- Have a reasonable basis to believe the recommendation is in the best interest of at least some of the BD's retail clients and the best interest of the particular client

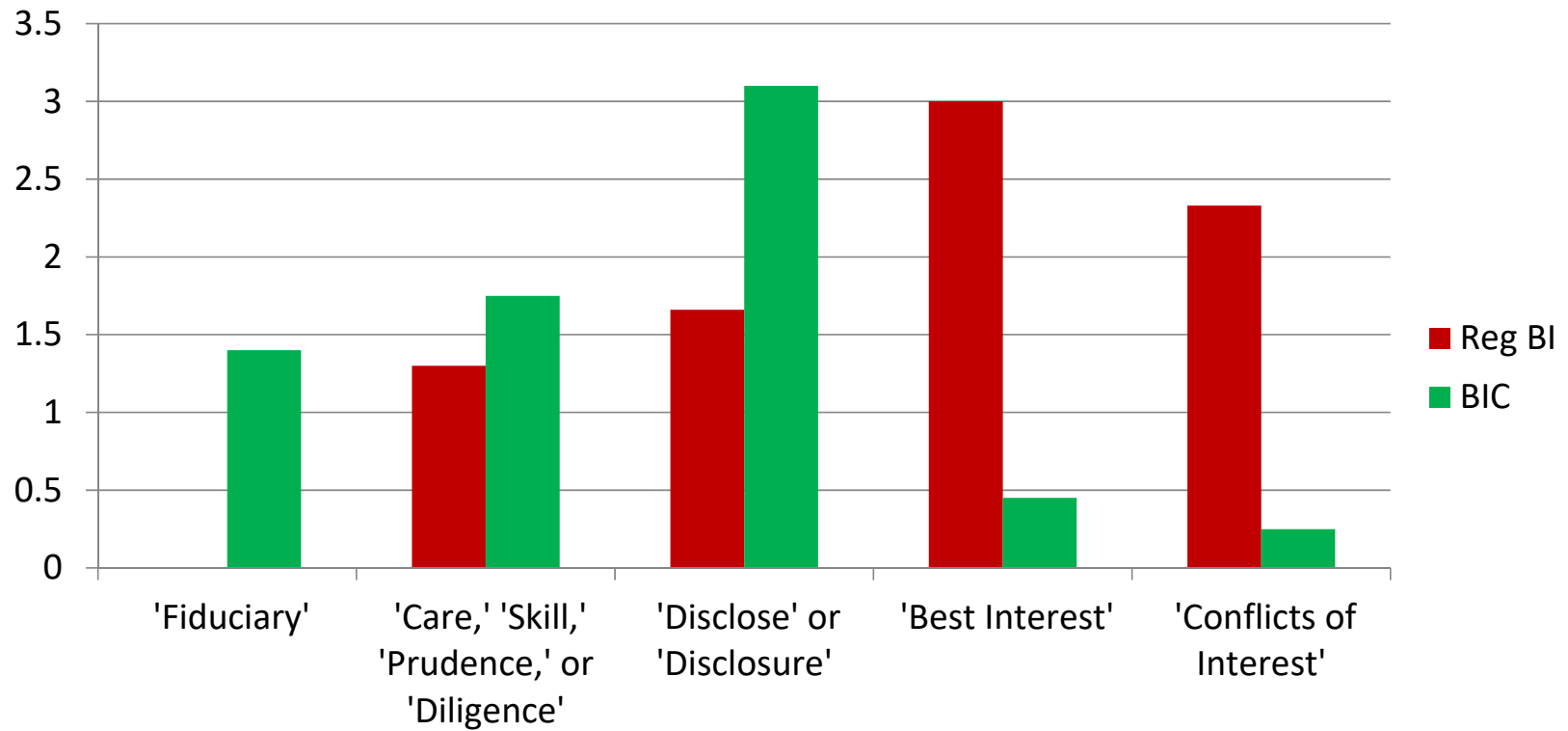
Reg BI – Four Obligations (continued)

3. Conflict of Interest Obligation: Establish, maintain and enforce written policies to
 - Identify and mitigate conflicts that create an incentive for reps to place their, or their firm's, interests ahead of the customer's interest
 - Identify and disclose material limitations on securities or investment strategies and conflicts associated with those limitations
 - Prevent limitations and conflicts (such as limited product menu) from subordinating customers' interests
 - Identify and eliminate sales contests, quotas, bonuses, and non-cash compensation that are based upon sales of specific securities or types of securities in a limited time period
4. Compliance Obligation: Establish, maintain and enforce policies and procedures designed to achieve compliance with Reg BI as a whole

Reg BI – Investor Advocate’s Take

- Investor Advocate Rick Fleming, in a statement at the time of the release
 - Calls Reg BI “a step in the right direction” that will “improve upon the suitability standard”
 - But also stated: “The most worrisome aspect of Reg BI is that it will allow broker-dealers and their associated persons to market themselves as acting in the best interest of their customers. If Reg BI is not enforced rigorously enough to demand behavior that matches customers’ expectations, then customers will be harmed by the new standard.”
- Taken as a whole, the four part package amplifies those concerns.

Comparison of Word Content* – SEC’s Reg BI to DOL’s BIC



*Average use per page

Form CRS – What's Required

- New disclosure form for BDs and RIAs
 - June 30, 2020 compliance deadline
- BDs file with CRD; RIAs file with IARD
 - Dual registrants can use separate BD or RIA disclosures, or combine
- Two-page limit (four for dual registrants)
- Disclosures limited to retail customers/clients; not institutional clients
- Three primary disclosure sections
 - Relationships and services
 - Fees, costs, conflicts and standard of conduct
 - Disciplinary history

Form CRS Delivery

- Within 30 days of filing Form CRS, deliver to existing retail clients
- Provide to new advisory clients before or at time agreement signed
- If filing amendments to Form CRS, communicate changes to clients in 60 days
- Also deliver to clients in following situations
 - Opening a new account that is different from old one
 - Recommending a rollover
 - Recommending a new service or product that doesn't require opening a new account or wouldn't be held in an existing account
- Post Form CRS in prominent location on firm website

Form CRS – Standard of Conduct Disclosure

Proposed

- *Broker-Dealers*

“We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities.”

- *Investment Advisers*

“We are held to a fiduciary standard that covers our entire investment advisory relationship with you.”

Final

- *Broker-Dealers*

“**When we provide you with a recommendation**, we have to act in your best interest and not put our interest ahead of yours.” [Boldface required]

- *Investment Advisers*

“**When we act as your investment adviser**, we have to act in your best interest and not put our interest ahead of yours. [Boldface required]

Fiduciary Guidance for Advisers

“But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry...”

-- Justice Frankfurter
SEC v. Chenery Corp., 1943

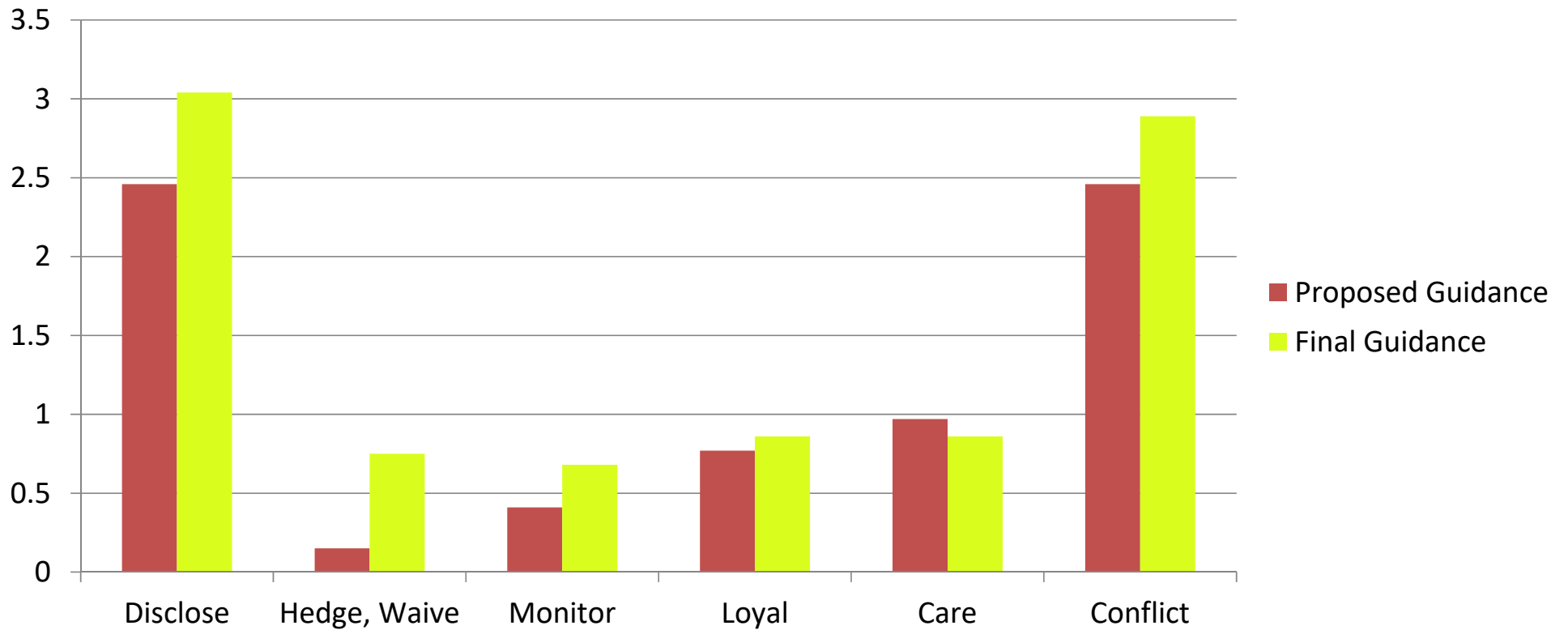
- SEC guidance intended to reaffirm and clarify aspects of an investment adviser’s fiduciary duty in a single release.
 - Investment advisers’ fiduciary duty comprised of a duty of care and duty of loyalty
- Guidance focuses on
 - Application of fiduciary duty
 - Aspects of duty of care
 - Disclosure under duty of loyalty

Fiduciary Guidance – Two Areas of Concern

- Application of fiduciary duty
 - Can be partially waived by contract, but
 - A hedge clause absolving RIA of fiduciary duty not permitted
 - Scope “may be shaped by disclosure and informed consent” provided client receives full and fair disclosure, provides informed consent
 - Unclear whether scope of relationship refers to fiduciary duty or scope of services
- Avoiding and managing conflicts: Either/or situation?
 - Proposed interpretation: “Must seek to avoid conflicts...and, at a minimum, make full disclosure of all material conflicts
 - Final interpretation appears to allow adviser to either avoid or disclose

Fiduciary Guidance – Areas of Emphasis*

*Usage per page



‘Solely Incidental’ Guidance

Two ‘prongs’ provide exemption from definition of ‘Investment Adviser;’ i.e., when performance of such services is

1. solely incidental to conduct of business as broker or dealer and
2. who receives no special compensation therefor

-- Sec. 202(a)(11)(C) of Advisers Act

- Last-minute addition to rules package
- Efforts made by SEC to define ‘solely incidental’ five times since 1978
- Latest interpretation allows solely incidental advice
 - Related to limited scenarios for securities transactions
 - Ongoing investment discretionary authority not ‘solely incidental’
 - Important factor is not investment advice but ‘making investment decisions...on an ongoing basis’

‘Solely Incidental’ Areas of Concern

- Broad definition of incidental advice

Interpreted by SEC to mean the provision of advice as to

1. the value and characteristics of securities; or
2. advisability of transacting in securities IF
3. the advice is provided in connection with and reasonably related to [BD’s] primary business of effecting securities transactions.

- Why now?

- Brokerage firms typically rely on ‘special compensation’ prong
- Opens door wider for ‘incidental’ advisory services in Form CRS

Closing Comments – Reg BI

- The “Four Obligations” raise the suitability standard
 - Disclosure
 - Care
 - Conflict of Interest
 - Compliance
- Likely to be implemented and enforced
 - The need to better protect retail investors is widely accepted
 - June 30, 2020 enforcement date is short; firms must act immediately
- “Best Interest” is a poor name for the rule and, taken together with the other parts of the regulatory package, is deceptive and counterproductive

Closing Comments – Form CRS

- Bad in the original proposal, much worse in the final
- Boilerplate language omitting “fiduciary” obscures the difference between conduct standards applicable to brokerage and advisory relationships
- Consider this from the Fifth Circuit decision vacating the DOL Fiduciary Rule:
“Stockbrokers and insurance agents are compensated only for completed sales ... Investment advisers are paid fees because they ‘render advice.’ ... Only in the DOL’s semantically created world do salespeople ... have ‘authority’ or ‘responsibility’ to ‘render investment advice.’”
- The SEC violates its own requirement that “all information in [Form CRS] must be true and may not omit any material facts necessary in order to make the disclosures ... not misleading.” Omission of “fiduciary” is a clear violation.

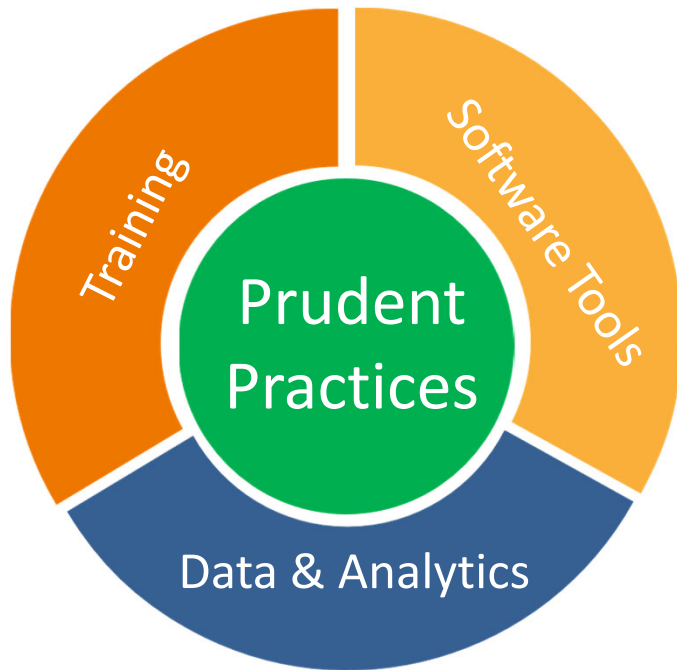
Closing Comments – Interpretative Guidance

- Interpretive guidance for RIAs may weaken the fiduciary standard
 - Suggests that clients’ interests need not be placed first
 - Brings into question the extent to which fiduciary duties can be waived by contract and conflicts can be addressed solely through disclosure
- The “solely incidental” interpretation expands the broker-dealer exclusion to effectively render the term meaningless
 - Only the form of compensation (fees versus commissions) seems to matter
 - Raises an “Elephants-in-Mouseholes” question
- The SEC’s two guidance documents raise many more questions than they answer. They seem unlikely to stand the tests of time and close scrutiny.

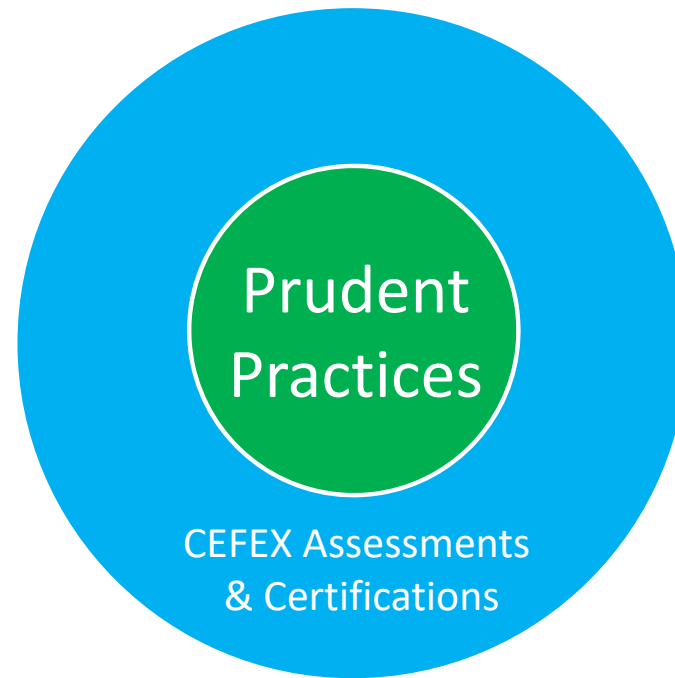
Closing Comments – Who controls your destiny?

- Regulations set the low bar on standards of conduct
- Litigation and shifts in the political climate will repeatedly reshape regulations
- State legislation adds an additional source of uncertainty
- The public is increasingly aware of the term “fiduciary”
- The 4-part Reg BI package intensifies polarization
 - Wall Street versus Main Street
 - Brokers versus advisers
- Regardless of business model, adhering to fiduciary principles is possible and desirable for clients, the profession of advice, and for business success
- In an environment of uncertainty, building a brandable reputation is paramount

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Q & A



Please submit any questions using the GoToWebinar interface

Download Fi360's Reg BI whitepaper at: www.fi360.com/SEC-RegBI

Additional questions can be sent to support@fi360.com

THANK
YOU
