

Standards of Conduct for Investment Advisers, Broker-Dealers Under SEC Review

Contributing Partner

Michael D. Dorum / New York

Associate

Christopher M. Gandia / New York

In the six months since Securities and Exchange Commission (SEC) Chairman Jay Clayton requested public comments on standards of conduct for investment advisers and broker-dealers, industry participants, investors and other commenters have filed more than 230 responses. The request comes long after the Dodd-Frank Act authorized the SEC to issue new rules to address the standards of care for broker-dealers and investment advisers, including potentially requiring broker-dealers to adhere to the same fiduciary standard as investment advisers under the Investment Advisers Act.

The request also follows the Department of Labor's (DOL) issuance of its fiduciary rule, which governs the standard of conduct for advisers and broker-dealers in relation to employee benefit plans, individual retirement accounts (IRAs), and other accounts and arrangements subject to the Employee Retirement Income Security Act (ERISA) and Section 4975 of the Internal Revenue Code (Code Section 4975). (See our *2017 Insights* article "[Change in Administration Presents Opportunity to Revisit DOL Fiduciary Rule](#).") As we begin the new year, the issue is ripe for SEC rulemaking.

Meanwhile, the effective date of certain DOL fiduciary rule provisions has been delayed. (See our December 5, 2017, client alert "[Department of Labor Extends Transition Period for Exemptions Under the Fiduciary Rule](#).") Secretary of Labor Alexander Acosta and Chairman Clayton have agreed that there is a need for coordination between the DOL and SEC, and the delay by the DOL has provided an opportunity for the agencies to develop their respective rules in a coordinated manner. Industry participants speculate that such coordination has the potential to weaken the existing standards applicable under the DOL fiduciary rule and the Investment Advisers Act.

Chairman Clayton requested public comments on the costs and benefits of the different standards of conduct that apply under current law to broker-dealers

for accounts that are under the jurisdiction of the SEC but not the DOL (such as securities accounts not involving employee benefit plans, IRAs, ERISA or Code Section 4965). Chairman Clayton also requested comments on the costs and benefits of having different standards of care for broker-dealers and investment advisers — a difference that predates the DOL fiduciary rule. In particular, the request seeks input regarding confusion that retail investors have expressed regarding the type of professional or firm providing investment advice to them and the attendant standards of conduct.

In addition, the request solicits comments regarding the experience of investors and other market participants with the efforts of broker-dealers to comply with the DOL fiduciary rule. It includes specific queries regarding the trend toward the fee-based model (and away from the commission-based model) for retail investment advice, which appears to be motivated at least in part by the need to comply with the DOL fiduciary rule.

Chairman Clayton's request was not connected to a specific rule proposal and did not impose a deadline for comments. Most of the comments to date support the imposition of a fiduciary standard for broker-dealers and the SEC's assumption of a leading role in the regulation of retail investment advice. However, questions remain as to how any new rules will address key issues, including:

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Four Times Square
New York, NY 10036
212.735.3000

- Will the SEC and DOL continue to exercise overlapping regulatory authority over the same investment accounts? Will different rules continue to apply to accounts regulated by the SEC only — as opposed to accounts regulated by both the SEC and the DOL, or by the DOL only? Will different rules continue to apply to broker-dealers and investment advisers?

- Will the new rules affect the trend toward the fee-based model? Will the DOL fiduciary rule provisions that contributed to that trend — including the requirement that commission-based arrangements be accompanied by “best interest” contracts requiring broker-dealers to act “without regard” to their own interests and prohibiting limitations on broker liability and class actions — survive the new rulemaking?

- To what extent will the new rules rely on new requirements for broker-dealers to provide disclosure to investors regarding the nature of the advisory relationship, rather than regulate the standard of conduct to which broker-dealers must adhere?

The answers to these questions will shape the environment for retail investment advice in 2018 and beyond.