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As SEC proposes new broker standards, some wave goodbye to DOL fiduciary rule

By Emma Trincale

New York, April 19 – The Securities and Exchange Commission proposed a package of rules designed to frame new standards for broker-dealers in their dealings with retail clients. For many lawyers and market participant, this is the first step in striking a final blow to the Department of Labor fiduciary rule.

The new proposals aim to “raise the standard of conduct for broker-dealers when they provide recommendations to retail investors and [reaffirm and clarify] the terms of the relationships that retail investors have with their investment professionals,” said SEC chairman Jay Clayton at an open meeting held on Wednesday, during which the rules were passed by a 4-1 vote.

This new rulemaking package has been the result of the SEC’s effort to step in and come up with its own fiduciary rulemaking after the Department of Labor’s fiduciary rule, already unpopular within the financial industry, was struck down last month by the U.S. Court of Appeals for the Fifth Circuit.

Best interest

The proposed “package” of rules from the SEC is divided in several different parts.

A rule called “Regulation Best Interest” requires a broker making an investment recommendation to act in the best interests of the customer at the time the recommendation is made, without placing the broker’s own interest or the firm’s interest ahead of the interest of the retail customer, according to a news release issued by the SEC.

Another set of proposals are designed to provide clarity on fees, conflicts and other material matters

“Put bluntly, we want investors to

understand who they are dealing with, i.e., what category – investment adviser, broker-dealer or dual-hatted – their investment professional falls into and, then, what that means and why it matters,” said Clayton in his presentation.

For instance, brokers will not be allowed to use the terms “adviser” and “advisor” as part of their names or title anymore, he said, adding that the similarity between those two titles and the term “investment adviser” may mislead the broker’s prospective customers.

Disclosure

Finally, the SEC announced a proposal that would require investment advisers and brokers to provide retail clients with a brochure of no more than four pages called a Customer/Client Relationship Summary, or form CRS. The disclosure would spell out key differences in the principal types of services offered, the legal standards of conduct that apply to each, the fees a customer might pay and certain conflicts of interest that may exist.

Not a rule yet

For issuers and wirehouse brokers who have had to adjust to the DOL rules for two years, the new SEC standard may come as a relief.

But will it prevail and replace the DOL standard for sure? And if not, how would the coexistence of two separate sets of rules from two distinct federal agencies with separate jurisdictions be possibly manageable given the complexity of such a situation?

“This is at the heart of the issue,” said George Michael Gerstein, co-chair of Stradley Ronon’s Fiduciary Governance Group.

“It is a little bit early to tell. What the SEC just announced are proposals. There’s

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a 90-day comment period first. After that, the SEC will need to make some changes and vote.

“This could take some time.”

DOL's next move

More fundamentally, the fate of the DOL rule will depend on this agency's reaction to the Fifth Circuit decision.

“DOL could decide to defend its fiduciary rule through an appeal to the U.S. Supreme Court or a rehearing with the 5th Circuit, in which case the rule would remain valid,” said Gerstein.

“Or they could simply accept the Fifth Circuit Panel decision.

“Right now the DOL rule has been vacated. But we don't know what's next. DOL has been very quiet on this.

“It's impossible to know if they're going to defend it. What they've just said is that they're not going to enforce it until further notice.”

A controversial ruling

The DOL regulates investment advice for retirement plans under the Employee Retirement Income Security Act of 1974 or ERISA.

Its rule, published in April 2016, imposed the more stringent ERISA fiduciary standard on brokers. It was met with a barrage of criticism from banks, asset managers, broker-dealers and insurance companies which complained of the high compliance costs involved in its enforcement, according to thousands of public comments from the industry.

Brokers also worried about the ease

with which clients may file lawsuits or class actions against them.

Finally since DOL does not have jurisdiction over non-retirement account, there was growing confusion over how to deal with a client who has an ERISA account and a non-ERISA account.

After many delays, the DOL in August announced that it will postpone the compliance deadline to July 1, 2019 from Jan. 1, 2018.

Strong opponents

“The DOL rule is on life support,” said Gerstein.

“Many people think that the DOL will

not appeal the ruling. We don't know for sure but the odds are in favor of a non-appeal because of a number of reasons, one of which is the administration skepticism of the rule.”

He cited president Donald Trump's

presidential memo issued in February 2017 ordering DOL to reexamine the fiduciary rule. The memo directed DOL to assess whether its fiduciary ruling had harmed investors, disrupted the industry and increased costs.

Addressing overlap

The SEC's Clayton during his speech on Wednesday voiced himself some of his own concerns.

“While the status of the DOL's rule is currently in doubt following the Fifth Circuit's ruling, during the time the rule was in effect it imposed an additional standard of conduct for broker-dealers, amplifying significant regulatory complexity and

uncertainty in this area, including through the introduction of multiple regulatory standards to the same investor relationship.”

The commissioner emphasized some of the risks by believes are caused by the rule.

“Our concerns regarding regulatory complexity go well beyond the impact of the DOL rule,” he said in his speech.

“I am concerned that there are an increasing number of inconsistencies in the standards of conduct applicable to the provision of financial advice – in regulatory text, inspection and enforcement – and therefore, regardless of the impact of the DOL rule, the potential for increased investor confusion and harm and decreased investor choice.”

For Gerstein, it seems pretty clear that the days of the controversial rule are numbered.

“If the DOL fiduciary rule remains valid, if they defend it, there would be a whole range of issues as to when the rule starts being enforced and how the rule would work with the SEC's own final rulemaking when the commission votes for it,” he said.

“It seems unlikely.”

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