NORTHERN TRUST

SEC PROPOSED REGULATION BEST INTEREST

Broker-Dealers and Registered Investment Advisors

OVERVIEW:

On April 18, 2018 the Securities and Exchange Commission (SEC) voted to propose three-part package of rules and interpretations focused on investors' relationships with investment professionals:

- Regulation Best Interest
- Interpretation of the Fiduciary Duty that Investment Advisers Owe their Clients
- Form CRS – Client Relationship Summary

The proposed rules and interpretations are designed to enhance the quality and transparency of investors' relationships with broker-dealers and investment advisers while preserving access to a variety of investment products and types of advice relationships.

KEY PROVISIONS:

The proposed Regulation Best Interest would require a broker-dealer to act in the best interest of a retail customer when making a recommendation for a transaction or strategy. The 408-page release proposes to establish an express best interest obligation of a broker-dealer to a retail customer and outlines three component requirements: (1) obligation to disclose terms and scope of services, including all material conflicts of interest ("Disclosure Obligation"; (2) exercise reasonable care, diligence, skill and prudence when making recommendations ("Care Obligation"); and (3) establish, maintain, and enforces written policies and procedures reasonably designed to identify, disclose, mitigate or eliminate all material conflicts of interest (i) associated with the recommendations, and (ii) arising from financial incentives associated with such recommendations ("Conflict of Interest Obligations"). The proposal requests comments generally, and on a number of specific questions.

The SEC proposed interpretative guidance seeking to reinforce and clarify "certain aspects of the fiduciary duty that an investment adviser owes to its clients" under the Investment Advisers Act of 1940. The 38-page proposal includes information on the SEC's proposed interpretation of the duties of care and loyalty, and requests comment on three points: (1) whether the proposed interpretation offers sufficient guidance with respect to the fiduciary duty; (2) whether there are any significant issues related to the adviser's fiduciary duty that are not addressed in the proposed interpretation; and (3) whether it would be beneficial to codify any portion of the proposed interpretation of fiduciary duty.

The third proposal covers new disclosure requirements to explain the nature of customer relationship with investment professionals through a new short-form disclosure document titled Form CRS, Client Relationship Summary. This standardized short form would inform retail investors about the relationships and services offered, the legal standards of conduct, fees and costs that investors may incur, conflicts of interest and whether the firm and its financial professionals currently have reportable legal or disciplinary events. The 471-page release also proposes to restrict the use of the term "adviser" or "advisor" in specified circumstances, to help reduce investor confusion. Comments are also requested on this proposal.

NEXT STEPS:

The SEC will seek public comment on the proposed rules for 90 days. Northern Trust will continue to track developments as they occur.

Contact us

Please contact your Northern Trust representative, if you have questions, or visit northerntrust.com

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