

As we look forward in terms of what to expect from the SEC with respect to the topic of fiduciary investment advice, it is important to first clarify what we mean when we use the term fiduciary.

For years we have heard that investment advisers are fiduciaries under the 1940 Act. However, the SEC has not always enforced its rules in a way that is consistent with true fiduciary principles. Going back to 1963 when the Supreme Court confirmed in the Capital Gains case that investment advisers were fiduciaries, the SEC generally expected advisers to deal with conflicts of interest through disclosure rather than avoidance or mitigation. Over the years, we have regularly seen the SEC deal with adviser conflicts of interest by penalizing firms that did not adequately disclose the conflicts rather than questioning why the conflicts existed in the first place.

With Regulation Best Interest, we are seeing the SEC take a different perspective. The regulation bans certain conflicts outright, and requires mitigation of other conflicts. I know there is concern that disclosure will be seen as an adequate mitigation measure, but I don't think that will be the case moving forward. The SEC is sending clear messages now that it expects something more from brokers.

Over the course of the next year, I expect we will see further guidance from the SEC about what will be deemed effective mitigation. And, although the states and FINRA are not responsible for interpreting Reg BI, they are responsible for enforcing it. Through enforcement actions, I expect we will get a clearer expression of what will be deemed insufficient mitigation. FINRA has traditionally required real mitigation of certain types of conflicts, and has reinforced that a broker cannot meet their obligations simply through disclosure alone. I expect FINRA will carry that perspective forward into its enforcement of Reg BI.

So, with respect to Reg BI, I don't expect we will see further rulemaking from the SEC that changes a broker's obligations under the rule, but I do expect we will see further guidance, and a more comprehensive understanding of what will be deemed acceptable conduct through the enforcement actions.

In terms of what that means more specifically, I think there will be focus early on in a few areas that directly exemplify where a broker may maximize their own compensation at the expense of their customers.

I think one of the more problematic areas for firms is with respect to differential compensation structures, especially in connection with complex products. Firms have justified paying brokers more for sales of more complex products because they require more of the broker's time. However, this raises serious conflicts, placing the broker's interests in direct competition with investors' interests. I expect there will be much greater scrutiny with respect to

recommendations of complex products, particularly when they are sold to retirees seeking steady income. We have seen so many cases where a broker has justified the recommendation because it produces income for the investor with no appreciation for the risk or illiquidity of the product. I expect we will see enforcement actions that make it clear that these sorts of recommendations are inconsistent with Reg BI.

I also expect we will see a focus on recommendations to roll over qualified retirement accounts into IRAs. This may be the single most important investment decision an investor makes, and a complicated decision as an investor weighs their options. This is another area where the broker's conflicts are plain – if the investor doesn't roll over their account, the broker doesn't get the business. I expect there to be greater scrutiny here as well, seeking a more thorough justification from firms and brokers as to why the advice to roll over meets the Impartial Conduct Standards under Reg BI.

Next I expect to see some focus on recommendations of account type. This will be important in the context of the dual registrants – those who are both investment advisers and brokers and can recommend both managed accounts and accounts that charge commissions based on transactions. I have seen cases where the dual registrant recommends that the buy and hold investments be placed in an advisory account and the complex, high commission products be placed in a brokerage account. In these situations, the investor doesn't understand that their investment professional has one duty with respect to the advisory account, and a different duty with respect to the brokerage account. Nor do they understand how they are paying them. However, it can be clear in these situations that the investors' interests are being subordinated to the broker's interests, and I expect the regulators will say that is not ok.

These are some of the areas where we may see early guidance and enforcement which should send a clear message that firms have to figure out how to manage these conflicts, or just avoid them altogether. I do not expect disclosing any of these conflicts will satisfy a firm's and a broker's duty to mitigate them. And I don't think further rulemaking is necessary to achieve that result.

I do expect that we will see more from the SEC with respect to investment advisers. The SEC is beginning to recognize that if it is going to consider investment advisers to be fiduciaries, it must expect more from them. I expect we are going to see the SEC shift its focus from an expectation of disclosure to an expectation of adherence to fiduciary principles – that is putting the investors' interests first and not simply informing them when you haven't.

I also expect we will see more from the SEC about how conflicts should be handled more generally. For example, as the SEC begins to look at digital engagement platforms, it will be examining the conflicts that are present when there is not a human broker intermediary involved in the transaction. Some of the questions the SEC is beginning to ask is How do

conflicts impact the firms that are offering online trading services? How does payment for order flow impact investors' interests?

Here too, I think we will see the SEC stepping back from its historic posture of just disclose the conduct, or disclose the conflict. I expect to see the SEC taking a more proactive approach that considers how conflicts may and should be managed or eliminated.

So, over the course of the next few years, I think we will see an SEC that is starting to shift what it expects from fiduciaries. I expect we will see the SEC begin to truly enforce the fiduciary standards – act in the best interests of your clients. Full stop.