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Update On SEC Best Interest Proposal/ State Fiduciary Laws/Regulations

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FEDERAL REGULATION

- At the start of 2018, the key issues were the fate of the DOL Fiduciary Rule and the SEC's anticipated standard of care regulation.

- The decision of the U.S. Court of Appeals for Fifth Circuit in *U.S. Chamber of Commerce v. DOL* nullified the DOL fiduciary rule nationwide when it issued its mandate in May 2018 vacating the "fiduciary rule in toto."

- The DOL fiduciary rule would have made broker-dealers, insurance agents and others who recommended investment products for ERISA or IRA accounts fiduciaries.

FEDERAL REGULATION
(cont'd)

- The SEC announced its proposed Regulation Best Interest in April 2018.

- SEC proposed a "best interest" standard that would require broker-dealers and registered representatives to act in the "best interest" of a "retail customer" at the time a "recommendation" of a securities transaction or investment strategy involving securities is made to a customer, without placing the financial or other interest of the broker-dealer or associated person ahead of the interest of the customer.

- The SEC also proposed a new requirement for both broker-dealers and investment advisers to provide a brief relationship summary to retail investors, and it published for comment a proposed interpretation of the standard of conduct for investment advisers.

FEDERAL REGULATION
(cont'd)

- SEC received thousands of comments in response to its proposal.
- There was general support among commenters that the SEC's proposals were well-intentioned and that the SEC should continue to take a lead on formulating a best interest standard for broker-dealers. However, many commenters felt the SEC's proposal was vague and went far beyond current broker-dealer obligations. Many commenters hoped the final rules would show significant improvements over the proposals.
- SEC's final rule is expected in 2019

STATE REGULATION

NEW YORK

- NYDFS issued its final Suitability and Best Interests in Life Insurance and Annuity Transactions, Insurance Regulation 187 (annuities and life insurance products)

- Places a duty on a "producer" or, where there is no producer, on the "insurer," to ensure that a "recommendation" for "a proposed or in-force" life insurance policy or annuity is in furtherance of the consumer's needs and objectives when taking into consideration only the interests of the consumer and without regard to the producer's or insurer's financial compensation or incentives.

STATE REGULATION
(cont'd)

- Contains criteria for determining if a recommendation is in the best interests of a consumer, provides for disclosure requirements, and sets forth compliance obligations.

- The regulation is to take effect on August 1, 2019 for annuity contracts and February 1, 2020 for life insurance policies.

- New York also has a pending bill in the state legislature, the Investment Transparency Act, which would require brokers and other non-fiduciary financial advisers to disclose to their clients that they are not fiduciaries and that they may recommend investments that provide for higher fees even if those investments do not have the best combination of fees, risks and expected returns for client.

- Prior attempt to pass this legislation in 2018 was unsuccessful.

STATE REGULATION
(cont'd)

MARYLAND

- Maryland Financial Consumer Protection Act of 2019 is currently pending in state legislature.

- Provides that broker-dealers, broker-dealer agents and insurance producers are fiduciaries and would require these individuals "to act in the best interests of the customer without regard to the financial or other interest of the person or firm providing the advice."

- Requires Commissioner of Financial Regulation to "adopt regulations to carry out the fiduciary duty required under this section," including regulations that (1) define, require, prohibit, or exclude an act, practice, or course of business of a person subject to the statute; and (2) prevent a person from engaging in acts, practices, and courses of business in violation of the statute.

State Regulation
(cont'd)

- Proposed legislation also would heighten the duty that investment advisers owe under Maryland law.

- Similar to prior unsuccessful bill in 2018. That legislation, however, directed the Maryland Financial Consumer Protection Commission to study whether Maryland should adopt a fiduciary standard.

- Commission issued report in January 2019 that recommended legislature adopt a fiduciary standard for broker-dealers, broker-dealer agents and insurance producers.

- Commission also recommended the strengthening of the fiduciary duty standard currently imposed on investment advisers in Maryland because they found it was currently weaker than the national fiduciary duty standard.

STATE REGULATION
(cont'd)

NEW JERSEY

- New Jersey Bureau of Securities announced in October 2018 that it would solicit comments on whether it should issue a regulation requiring broker-dealers and investment advisers to be fiduciaries without providing any proposal.
- Hearings occurred in November 2018 and comment period closed in December 2018
- Proposed regulation expected in 2019
- New Jersey also has a pending bill that would create disclosure obligations for non-fiduciary investment advisors similar to the legislation pending in New York.

STATE REGULATION
(cont'd)

NEVADA

- Passed legislation effective July 1, 2017 providing that a "financial planner" has "a duty of a fiduciary toward a client." Legislation also imposes a fiduciary duty on broker-dealers, sales representatives and investment advisers who for compensation advise other persons concerning the investment of money
- Does not apply to sales of insurance unless the sale is accompanied by investment advice
- Implementation dependent on regulations

STATE REGULATION
(cont'd)

- On January 18, 2019 Nevada released draft regulations
- Comment period ended on March 1, 2019

STATE REGULATION
(cont'd)

NAIC

- Released draft amendments to Suitability in Annuity Transactions Model Regulation (#275) on November 19, 2018
- Not a fiduciary standard. Requires insurers to act in the consumer's interest without placing its financial interest head of consumers.
- Before recommending an annuity, insurers would be required to disclose: (1) the scope and terms of their relationship with the consumer; (2) any limitations it has; (3) how it is being compensated; and (4) any material conflicts of interest.
- Completion of revisions expected in 2019

STATE REGULATION
(cont'd)

ISSUES MOVING FORWARD

- Challenges to rulemaking by state regulatory agencies (i.e., lawsuit by Nation Association of Insurance and Financial Advisors for New York State challenging best interest regulation)

- Potential federal preemption or other challenges to state legislation

- Industry reaction to state legislation/regulation and potential impact on marketplace for customers (i.e., Morgan Stanley response to proposed Nevada regulation stating that "absent substantial changes to the proposal, Morgan Stanley will be unable to provide brokerage services to the residents of the state of Nevada.")

RESOURCES

Stradley Ronon Fiduciary Governance Blog

https://fiduciarygovernanceblog.com/