STRADLEY RONON

Fiduciary Governance

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Fiduciary Governance 2.0

We are pleased to introduce Stradley Ronon's new [Fiduciary Governance Group], comprised of federal and state securities, banking, insurance and ERISA/governmental plan law attorneys who help clients determine (1) whether one becomes a fiduciary or assumes a similar role under common law and applicable regulatory regimes, (2) how to comply with such fiduciary or similar duties under each set of laws and identify *daylight* between them, and (3) ways to leverage existing compliance procedures under one regime to comply with other applicable regimes. Whether it's the Department of Labor (DOL) Fiduciary Rule, a new Securities and Exchange Commission (SEC) fiduciary standard, or emerging state investment advice laws implicating broker-dealers and SEC-registered investment advisers, the Fiduciary Governance Group helps guide financial institutions on ways to address compliance risk in a holistic fashion and, where possible, create harmonized procedures that satisfy multiple applicable fiduciary rules and standards. Commentary from the group on fiduciary topics will be available through client alerts and on its blog at fiduciarygovernanceblog.com.

Here Today, Gone Tomorrow?

In one fell swoop, the 5th Circuit Court of Appeals dropped the hammer on the DOL Fiduciary Rule, tossing out the expanded scope of fiduciary "investment advice" and the related exemptions, including the Best Interest Contract Exemption. Barring a petition for rehearing or appeal, the court's ruling will go into effect in early May, at which point the 1975 DOL regulation defining investment advice via a five-part test would re-emerge.

Nevertheless, until there is certainty that there will be no rehearing or appeal, we caution against any major changes to compliance, even though the DOL has told the press that it will not enforce the rule until further notice. But now might be a good time to *consider* a post-DOL Fiduciary Rule world by:

- Inventorying the type and nature of typical communications with retirement investors (e.g., other fiduciaries, plan participants, IRAs, etc.) and tagging those that might satisfy all five prongs of the 1975 regulation: (1) providing advice as to the value of securities or other property, or making recommendations as to the advisability of investing in, purchasing, or selling securities or other property; (2) on a regular basis; (3) pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary; that (4) the advice serves as a primary basis for investment decisions with respect to plan assets; and that (5) the advice is individualized based on the particular needs of the plan or IRA.

- Identifying any representations, disclosures or statements regarding fiduciary status that were made in light of the Fiduciary Rule's scope, which may at some point need correction.

- Re-examining what changes were made to internal policies and procedures to account for the DOL Fiduciary Rule, and considering whether to retain such changes even if no longer legally required, particularly in light of the fact that federal and state regulators could seek enforcement against institutions for failing to follow these policies and procedures.

- Reconsidering any revisions to contracts in order to satisfy the DOL's guidance on 408(b)(2) disclosures that it issued last August. Recall that the DOL said: "In the case of a service provider who is providing or reasonably expects to provide fiduciary investment advice services within the meaning of the currently applicable Fiduciary Rule and whose contract with or disclosures to an ERISA pension plan client include a statement that the service provider is not a fiduciary or is not providing fiduciary services, the Department would not treat the service provider as having furnished the plan with an accurate and complete description of the services that will be performed under the contract or arrangement until a revised contract or disclosure is provided that removes or corrects that affirmatively incorrect statement." Because these same services may no longer be fiduciary in nature post-Fiduciary Rule, and recognizing the uncertainty service providers face at this time, rethinking these changes may make sense.

- Re-evaluating whether to continue excluding small plans and IRAs from investing in private funds, if that determination had been made to prevent a fund manager from inadvertently becoming an investment advice fiduciary to an IRA investor or small plan during the sales and subscription process.

We do not think it is a foregone conclusion that the 1975 five-part test of what it means to be an investment advice fiduciary under ERISA will be reinstated and that the DOL Fiduciary Rule has begun its ride into the sunset. We do believe, however, it is reasonable to begin considering tasks that will be necessary to transition to a post-DOL Fiduciary Rule world.

SEC's New Best Interest Standard … Coming (Very) Soon?

Regardless of whether the DOL seeks to preserve its Fiduciary Rule, Jay Clayton, the Chair of the SEC, has made clear that he expects the SEC to propose its own uniform standard of conduct for investment advisers and broker-dealers who provide personalized investment advice about securities. The 2010 Dodd-Frank Act authorized the SEC to adopt a uniform standard for broker-dealers and investment advisers to act in the best interest of the customer without regard to the financial or other interest of the entity providing the advice. We understand that the SEC is working on a rule proposal. Following the 5th Circuit decision on the DOL rule, Clayton reiterated that he hopes to get a proposal out as soon as possible, which we understand could be in a matter of weeks.

One likely aspect of the SEC proposal will be a requirement to deliver a summary disclosure document that will describe services, fees, conflicts, product offerings and other pertinent information. Such a document has been in the wings since the SEC staff's 2012 study on financial literacy among investors, which found that investors prefer, wherever possible, the use of a summary document containing key information about an investment product or service. The proposal may not expressly use the term "fiduciary," but will most likely impose a uniform duty to act in the "best interests" of clients and prohibit, or at least limit, the use by broker-dealers of certain titles, such as "financial adviser," in marketing and sales materials.

As a general principle, we expect the SEC to use as its base the federal fiduciary standard applicable to investment advisers, as laid out in *Capital Gains Research*, where the U.S. Supreme Court noted:

> [t]he Investment Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested.

As such, the federal fiduciary duty that flows from being registered under the Advisers Act provides that advisers have "an affirmative obligation of utmost good faith and full and fair disclosure of all facts material to the client's engagement of the adviser to its clients, as well as a duty to avoid misleading them."

State Action: Already Several Shots Across the Bow

We have been closely tracking the state developments on retail investment advice. Much has been reported on **Nevada's** newly revised financial planner law, which went into effect last summer. Our conference call last fall came on the heels of our attendance at the Nevada Security Division's Workshop on the new law and prospective regulations. As things stand, federally regulated investment advisers, broker-dealers and sales representatives that render financial planning services are now newly-minted "financial planners" under Nevada law, and as a result are subject to:

- The "duty of a fiduciary toward a client" and;
- A time-of-sale disclosure of "any gain the financial planner may receive, such as profit or commission, if the advice is followed" and;
- A duty to undertake a "diligent inquiry of each client to ascertain initially, and keep currently informed concerning, the client's financial circumstances and obligations and the client's present and anticipated obligations to and goals for his or her family."

Importantly, Nevada's financial planner law provides for a private right of action for breaches of "any element" of this fiduciary duty, or when the financial planner is "grossly negligent in selecting the course of action advised, in the light of all the client's circumstances known to the financial planner." There could also be civil litigation for violations of "any law of this State in recommending the investment or service."

The Nevada Securities Division has enforcement authority, as well as the authority to "[d]efine or exclude an act, practice or course of business of a broker-dealer, sales representative, investment adviser or representative of an investment adviser as a violation of the fiduciary duty toward a client," via regulations, which are expected to be proposed over the next couple of months. When proposed, the regulations will have to account for, and address, serious concerns that enforcement of this newly amended law may be preempted by The National Securities Markets Improvement Act of 1996 (NSMIA) and other federal law. Nevada Democratic Senate Majority Leader Aaron Ford, the sponsor of the legislation (who subsequently announced his intention to run for state attorney general), said in an interview that he is "confident" the law will "comport with what the federal government may do," specifically referencing the DOL Fiduciary Rule. It remains to be seen whether the preemption concerns involving NSMIA are being carefully considered.

The forthcoming regulations from the Nevada Securities Division are subject to final approval by the "Legislative Counsel Bureau" (also referred to as the "Legislative Commission"), on which Ford and other legislators sit. In an interview, Ford intimated that he and others would not hesitate to send the Securities Division back to the drawing board if the regulation does not reflect (enough) of their legislative intent. He also vowed, "We'll be back again in 2019" should the law be struck down by a court on preemption grounds.

With less fanfare, **Connecticut** passed a law last summer affecting financial planners, though, unlike Nevada, it did not expressly shoehorn broker-dealers and investment advisers into its scope. Rather, Connecticut defines financial planner as "a person offering individualized financial planning or investment advice to a consumer for compensation where such activity is not otherwise regulated by state or federal law." A reasonable (though not certain) reading of that definition is that federally regulated broker-dealers and advisers are not included at this. The law establishes a number of new requirements for financial planners, including a duty to disclose "whether they have a fiduciary duty with regard to each recommendation they make" upon request.

New York and **New Jersey** have introduced very similar bills that take a different approach than Nevada. New York's Investment Transparency Act, for example, applies to "investment advisors currently not subject to a fiduciary standard under existing state and federal laws or regulations or by any applicable standards of professional conduct," or, as the bill calls them, "non-fiduciary investment advisors." Specifically, "non-fiduciary investment advisors" includes those who identify themselves as "brokers," "dealers," "investment advisors," "financial advisors," "financial planners," "financial consultants," "retirement planners," "retirement brokers," "retirement consultants," or any other term that is suggestive of investment, financial planning or retirement planning knowledge or expertise. These entities will need to make a "plain language disclosure orally and in writing" at the start of the relationship that reads: "I am not a fiduciary. Therefore, I am not required to act in your best interests, and am allowed to recommend investments that may earn higher fees for me or my firm, even if those investments may not have the best combination of fees, risks, and expected returns for you." Both the New York and New Jersey bills require that "non-fiduciary investment advisors" maintain as a record the written acknowledgment signed by the client that the disclosure was in fact made. As of the date of this alert, the New York bill sits with the Committee of Codes and the New Jersey bill is pending technical review by the Legislative Counsel, after being re-introduced at the start of 2018.

Meanwhile, **Maryland** and **Illinois** are a tale of two different legislative approaches. The Maryland legislature attempted to take a Nevada-like approach, before reportedly sidelining its legislative efforts until the SEC unveils its best interest proposal. As introduced, the Maryland bills specifically imposed a fiduciary standard on broker-dealers and required a diligent inquiry of each client to determine the financial circumstances and obligations of the client, including an inquiry into the client's present and anticipated obligations to his or her family and "for the client's family and goals for the client's family." Illinois, in contrast, seems to be following more in the footsteps of New York and New Jersey: in early February, the Investment Advisor Disclosure Act was introduced in the General Assembly, and while we are not aware of any text that has been proposed yet, its name suggests mandated disclosures on lack of fiduciary status could be in order.

Whether more states will act in response to the 5th Circuit's decision on the DOL Fiduciary Rule is anyone's guess. We know that a number of state legislatures have pointed to skepticism over rulemaking by the DOL and SEC as a basis for their own legislative and regulatory efforts. With the DOL's own rule seemingly on life support, and the SEC's yet to be unveiled, it is impossible to forecast if other states, which are currently on the sidelines, will move forward with their own legislative or regulatory initiatives. We are continuing to monitor this evolving situation.

It is also unclear how state enforcement agencies will respond to the 5th Circuit decision. Just in February, prior to the court decision, the Massachusetts Securities Division filed an administrative complaint against Scottrade alleging that Scottrade violated the DOL Fiduciary Rule's "impartial conduct standards," and, therefore, violated state law. Massachusetts was effectively seeking to enforce the DOL rule. Consider whether state securities regulators may attempt again to bring a state enforcement action that is predicated on imputing the DOL Fiduciary Rule's "impartial conduct standards" into its own blue sky laws, *even if* those same standards are extinguished because the DOL Fiduciary Rule is (ultimately) abandoned. Moreover, if the SEC incorporates some aspect of the impartial conduct standards into its new proposal, would that encourage or discourage more of these state enforcement actions? In light of the Massachusetts complaint lodged against Scottrade, it is especially important for each firm to review its written policies and procedures – especially those amended to address the DOL Fiduciary Rule – to ensure that their terms are always followed, and if they are no longer legally compelled, to consider removing them from the policies and procedures, as flagged above.

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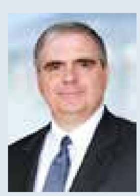

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Fiduciary Governance Group members:

Lawrence Stadulis co-chairs the fiduciary governance group and advises clients in matters pertaining to the registration and regulation of investment advisers and investment companies under federal and state securities laws. He also manages related issues pertaining to investment advisers and investment companies, including matters involving ERISA, broker-dealer regulation and banking laws.

George Michael Gerstein co-chairs the fiduciary governance group and advises clients on the fiduciary and prohibited transaction provisions of ERISA. He counsels banks, trust companies, broker-dealers, investment managers, private fund (including hedge funds and private equity funds) sponsors, and advisers on their responsibilities under federal law when managing plan assets. George routinely advises clients on the DOL Fiduciary Rule and other fiduciary developments at the federal and state levels, and additionally, he counsels clients on fiduciary-like duties and restrictions under other laws, including federal and state banking requirements, and the rules and regulations of governmental plans.

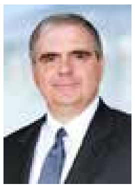
Alan Goldberg represents registered investment companies and their independent board members, registered investment advisers, sponsors to unregistered investment pools and family offices. He handles all aspects of creating registered investment companies and registering new investment advisers, including the establishment of compliance policies and procedures. Alan regularly prepares regulatory filings and applications on behalf of investment companies, including mutual funds, exchange-traded funds, closed-end funds and investment advisers, and he has performed numerous comprehensive compliance reviews of investment advisers and investment companies.

David Grim, most recently Director of the U.S. Securities and Exchange Commission's Division of Investment Management, provides counsel on all aspects of investment management law. He assists clients with a unique perspective developed during his over 20 years of public service at the SEC, including his time as one of only a small number of people who has served as the top regulator of the asset management industry. Dave joined the Division of Investment Management in 1995 directly from law school and rose to become its leader. He developed regulatory policy and legal guidance for investment advisers and investment companies, including mutual funds, exchange-traded funds, closed-end funds, variable insurance products, unit investment trusts and business development companies.

Sara Crovitz, most recently Deputy Chief Counsel and Associate Director of the U.S. Securities and Exchange Commission's Division of Investment Management, provides counsel on all aspects of investment company and investment adviser regulation. She worked at the SEC for 21 years, including 17 years in the Division of Investment Management focusing on issues under the Investment Company and Investment Advisers Acts of 1940. While in the Division, Sara supervised the provision of significant legal guidance to the investment management industry through no-action and interpretive letters, exemptive applications, IM guidance updates and other written and oral means.

Paula Shaffner chairs the securities litigation & enforcement practice group and is widely recognized as a fierce advocate for clients in the financial services industry. For almost 30 years, she has represented individuals and companies in securities litigation, and defended clients in regulatory matters before the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Agency and various exchanges and state regulators, and also represents clients in litigation filed in court or arbitration. In addition, Paula conducts internal investigations and provides compliance counseling.

Christopher Connell co-chairs the banking practice group. He focuses his practice on the representation of financial institutions and other corporate clients in a variety of transactional matters, including mergers and acquisitions, offerings of debt and equity securities (both public and private), initial public offerings, and securities matters for public company financial institutions. Chris also regularly advises financial institutions with respect to various federal and state regulatory and compliance matters and other general corporate law and governance issues.



John Baker focuses his practice on complex securities law and banking issues for mutual funds and their boards of directors/trustees, investment advisers, broker-dealers, banks, hedge funds and other participants in the financial markets. Prior to joining Stradley Ronon, he was senior counsel for a leading Boston financial institution, where he served as the primary legal advisor to the bank in its role as investment adviser to mutual funds with more than $9 billion in assets.

James Podheiser chairs the employee benefits practice group. He advises individuals, and for-profit and nonprofit organizations of all sizes and within all industries on employee benefits law, deferred compensation arrangements, stock plans, employee vs. independent contractor issues and all aspects of ERISA. Jim's practice encompasses plan design and administration, evaluation of plan compliance and liability issues in connection with merger, acquisition and lending transactions, and representing clients before government agencies in connection with employee plan matters.

Alison Fuller regularly counsels investment companies, investment advisers and independent trustees on federal and state securities law matters. She worked at the U.S. Securities and Exchange Commission for 10 years, including eight years as Assistant Chief Counsel in the Division of Investment Management. While at the SEC, Alison worked on more than 80 substantive no-action letters and helped develop key positions on matters involving the investment management industry.

Thomas Hanley chairs the public companies practice group. He advises public and private companies on corporate and securities law issues, including capital-raising transactions, mergers and acquisitions, corporate governance, SEC compliance and corporate litigation. Tom also counsels management, in-house counsel, boards of directors, board committees and investors on fiduciary duty issues, takeover defense, proxy contests/contested elections and related issues. Prior to entering private practice, he served as an attorney in the SEC's Division of Corporation Finance, and now serves as a primary liaison between clients and SEC, NYSE and Nasdaq staffs on disclosure, governance, listing and interpretive issues.

William Mandia represents financial institutions and insurers in complex commercial and class action litigation. He regularly defends and advises life insurers, intermediaries, banks, broker-dealers, investment advisers, and other financial services providers in connection with sales practices claims arising from a wide range of financial and life insurance products, including, but not limited to, claims for alleged breach of fiduciary duty, fraud, and violations of state consumer protection laws.

Nicole Kalajian represents securities and commodities professionals in a variety of regulatory, compliance and corporate matters. She provides legal and compliance guidance to registered and exempt investment advisers, commodity pool operators, commodity trading advisers, introducing brokers, FX firms, proprietary trading firms and broker-dealers; serves as counsel to boards, mutual funds and exchange-traded funds; and drafts and develops offering documents, compliance manuals, policies and procedures, corporate materials, contracts/investment agreements and advertising materials. Nicole also provides legal and structuring guidance concerning master-feeder structures, domestic and foreign funds, international offerings and separately managed accounts.

Michael Schapiro focuses his practice on counseling investment companies (including mutual funds, closed-end funds and exchange-traded funds) private funds, and investment advisers in connection with various regulatory, compliance and transactional matters. Prior to joining Stradley Ronon, he was an associate at another Washington, DC law firm where he concentrated his practice on counseling broker-dealers and investment advisers regarding regulatory and compliance issues before the SEC and FINRA.