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August 7, 2018

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Via Electronic Filing

Re: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Rel. No. IA- 4889; File No. S7-09-18

Dear Mr. Fields:

Ropes & Gray LLP appreciates the opportunity to provide these comments to the Commission on the above-referenced matter.

Our firm represents the interests of many asset management firms that are registered with the Commission as investment advisers. Given the relevance of the above-referenced proposed interpretation regarding investment advisers' standard of conduct (the "Interpretation"), we are writing to provide our views on aspects of the Interpretation. The comments expressed herein reflect the views of our firm, particularly as practitioners with many years of experience in providing legal counsel to investment advisers.

1. The Proposed Interpretation, with Certain Modifications, Could Be a Useful Tool for Investors and Investment Advisers

The Commission proposed two rules at the same time as it proposed the Interpretation: Regulation Best Interest¹ and the Client Relationship Summary Form.² The Interpretation states that, in light of the accompanying proposed rulemakings, the Commission "believe[s] it would be appropriate and beneficial to address in one release and reaffirm – and in some cases clarify – certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act."³

¹ Exchange Act Rel. No. 34-83062 (Apr. 18, 2018).

² Investment Advisers Act Rel. No. IA-4888 (Apr. 18, 2018).

³ 83 Fed. Reg. at 21204 (May 9, 2018) (footnotes omitted).

While we are not aware that there are significant disagreements about the scope and basic components of the fiduciary duty under the Investment Advisers Act⁴ (the “Advisers Act”), a formal Commission interpretation may benefit both investors and registered investment advisers, provided that it is presented carefully and with restraint. Investors should be able to use such a document in order to understand better the fiduciary duty owed to them by an SEC-registered investment adviser. Likewise, investment advisers may find such an interpretation to be helpful in ensuring that they are fully adhering to their fiduciary duty. In each case, however, the benefits of clarification should be weighed against the potential complications to a fundamentally sound existing standard, should the new guidance introduce heretofore unfamiliar concepts and burdens on investment advisers.

While the objective of the Interpretation is sound, we believe the proposed Interpretation needs revisions and clarifications in order to achieve its stated purpose. The Interpretation is properly intended to provide a Commission interpretation of advisers’ *existing* fiduciary obligations – not to add to or subtract from existing law.⁵ We respectfully suggest that the Interpretation should be refined in order to ensure that it does not go beyond or mischaracterize current law.⁶

2. Full and Fair Disclosure, as Established by the U.S. Supreme Court, Is a Core Element of the Advisers Act Fiduciary Duty

The Interpretation properly notes that the Advisers Act fiduciary duty comprises a duty of care and a duty of loyalty.⁷

The Interpretation also properly notes that a fundamental keystone of the Advisers Act fiduciary duty has long been accepted as the U.S. Supreme Court’s decision in *SEC v. Capital Gains Research Bureau*.⁸ For more than five decades, the *Capital Gains* decision has provided the basis for the federal common law interpretation of the Advisers Act’s prohibitions on fraudulent, deceptive, and manipulative acts or practices and served to outline core aspects of the Advisers Act fiduciary duty, including the duty to provide full and fair disclosure to advisory clients. The decision is cited routinely as holding that the Advisers Act imposes a fiduciary duty on registered

⁴ 15 U.S.C. § 80b-1, et seq.

⁵ We recognize that the Commission is requesting comments on matters that go beyond current law (*see* Request for Comment on Enhancing Investment Adviser Regulation), but the Interpretation is designed to address aspects of *existing* Advisers Act fiduciary law. “[I]n addition to our interpretation of *advisers’ existing fiduciary obligations...*” 83 Fed. Reg. at 21205 (emphasis added).

⁶ We note that the Commission already imposes a regulatory requirement for all investment advisers to establish, maintain and enforce a written code of ethics that, at a minimum, includes a standard of business conduct that reflects the adviser’s “fiduciary obligations” and fiduciary obligations of the adviser’s supervised persons. *See* 17 C.F.R. § 275.204A-1.

⁷ Interpretation, 83 Fed. Reg. at 21205.

⁸ 375 U.S. 180 (1963).

investment advisers.⁹ It is worth dwelling for a moment, therefore, on what the *Capital Gains* decision does and does not hold.

The *Capital Gains* decision repeatedly underscores the importance of full disclosure in imposing the standard of care on those who are subject to the Advisers Act, as illustrated by the excerpts recited below (some of which are referenced in the proposed Interpretation):

- In discussing the enactment of various securities laws following the 1929 market crash, the *Capital Gains* Court stated that “[a] fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.”¹⁰
- In discussing congressional intent underlying the Advisers Act, the Court noted that the “Investment Advisers Act of 1940 thus 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.”¹¹
- In discussing the elements of fraud in equity, the Court stated that “[c]ourts have imposed on a fiduciary an affirmative duty of ‘utmost good faith, and *full and fair disclosure of all material facts*,’ as well as an affirmative obligation ‘to employ reasonable care to avoid misleading’ his clients.”¹²
- In discussing the facts of the case (in which a registered adviser purchased shares of a particular security shortly before recommending it to subscribers of its monthly report to investors), the Court ruled that “[a]n investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, *through appropriate disclosure*, in deciding whether an adviser is serving ‘two masters’ or only one, ‘especially if one of the masters happens to be economic self-interest.’ Accordingly, we hold that the Investment Advisers Act of 1940 empowers the courts, upon a showing such as that made here, to require an adviser to make *full and fair disclosure* of his practice of trading on the effect of his recommendations.”¹³

⁹ See, e.g., *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979): “As we have previously recognized, § 206 [of the Advisers Act] establishes ‘federal fiduciary standards’ to govern the conduct of investment advisers.” 444 U.S. at 17.

¹⁰ *Supra*, n.8, at 186 (footnote omitted). The Court goes on to quote a related decision: “It requires but little appreciation...of what happened in this country during the 1920’s and 1930’s to realize how essential it is that the highest ethical standards prevail.” 375 U.S. at 186. While some argue that a disclosure-based fiduciary duty is somehow deficient, these passages from *Capital Gains* underscore the fact that such a duty embodies the highest ethical standards.

¹¹ *Supra*, n.8, at 191-192 (emphasis added; footnote omitted).

¹² *Supra*, n.8, at 194 (emphasis added; footnote omitted).

¹³ *Supra*, n.8, at 196-197 (reference and footnote omitted; emphasis added). The SEC itself argued for disclosure in the *Capital Gains* case – rather than elimination of the conflict. The Court noted that some testimony before the SEC

In short, the proper understanding of the *Capital Gains* decision is that the Advisers Act fiduciary duty is a duty to clients that is circumscribed by the advance disclosure that an adviser gives to its clients. The *Capital Gains* decision makes no mention of a duty to act in the best interests of a client – and certainly not a duty that cannot be circumscribed by fair, full and advance disclosure (as measured against the sophistication of the investor). The disclosure-based fiduciary duty is the reading that, in our experience, most legal practitioners and investment advisers have given to the fiduciary duty standard expressed in the *Capital Gains* decision.¹⁴ In addition, in our numerous dealings with the Commission’s inspection and enforcement staff, absent a credible assertion of bad faith, advance and specific disclosure of an activity has consistently been accepted as a defense against breach of fiduciary duty claims arising from such activity, even when the activity was not in the best interests of the client. Our discussions with Commission staff have revolved around whether the disclosure of a conflict of interest involving the adviser was timely and sufficiently clear and specific, not whether the conflict was a *per se* breach of fiduciary duty notwithstanding adequate disclosure.

The Interpretation accurately notes that the *Capital Gains* decision and numerous Advisers Act rules support the proposition that an investment adviser is a fiduciary and, as such, is held to the

argued for elimination of a conflict involving investment advisers trading on their own account, but stated that: “[w]e need not go that far in this case, since here the Commission seeks only disclosure of a conflict of interests with significantly greater potential for abuse than in the situation described above.” 375 U.S. at 196.

¹⁴ The *Capital Gains* decision has been cited favorably in subsequent U.S. Supreme Court decisions. See *Lowe v. SEC*, 472 U.S. 181, at 190 (1985); *Transamerica Mortg. Advisors, Inc. v. Lewis*, *supra*, n.9, at 11, 17-18, 22-23, n.13; *Burks v. Lasker*, 441 U.S. 471, at n.10 (1979); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, at n.11 (1977). See also *Geman v. SEC*, 334 F.3d 1183 (10th Cir. 2003): “It is clear that the firm did not live up to its duties of disclosure as a fiduciary. By failing to inform its customers fully about the way it was conducting trades as a principal, the firm deprived its customers of the opportunity to obtain for themselves the more favorable prices that the firm was realizing in two-thirds of its principal trades. Clearly the firm was guilty of breaching its fiduciary duties in this respect.” 334 F.3d at 1190. The disclosure-based fiduciary duty is akin to the provisions of section 206(3) of the Investment Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly “acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.” We also note that Form ADV requires investment advisers to “provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them.” General Instructions for Part 2 of Form ADV, Number 3 (“Disclosure Obligations as a Fiduciary”), available on the SEC website. The Commission has reaffirmed its disclosure-based approach, consistent with the *Capital Gains* decision, in various enforcement proceedings. See, e.g., *In the Matter of The Robare Group, Ltd., Mark Robare, and Jack L. Jones, Jr.*, Investment Advisers Act of 1940 Rel. No. 4566 (Nov. 7, 2016). The Commission’s *Plain English Handbook* sets forth techniques that investment advisers and other registrants can use “to create clearer and more informative disclosure documents.” *Plain English Handbook: How to create clear SEC disclosure documents* (Aug. 1998), available on the SEC website. For a discussion of aspects of the Advisers Act fiduciary duty and private funds, see *A Federal Fiduciary Standard Under the Investment Advisers Act of 1940: A Refinement for the Protection of Private Funds*, Harvard Bus. L. Rev. (Dec. 6, 2016).

highest standard of conduct.¹⁵ As one legal scholar has noted, the *Capital Gains* decision stands for the proposition that investment advisers “must adhere to a strict fiduciary standard including a duty of ‘utmost’ good faith, full and fair disclosure of material facts, and an obligation to use reasonable care to avoid misleading clients.”¹⁶ Thus, in the absence of a showing of bad faith on the part of the adviser, the remaining components of the Advisers Act fiduciary duty can be measured against the yardstick of the nature, timing and extent of disclosure provided to clients. The proposed Interpretation appropriately states that the duty of loyalty requires an adviser to “make full and fair disclosure to its clients of all material facts relating to the advisory relationship” and “must seek to avoid conflicts of interest with its clients, and, *at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship.*”¹⁷ We believe these statements in the proposed Interpretation provide an accurate description of the requirement for investment advisers to provide full and fair disclosure to their clients under the Advisers Act fiduciary duty.¹⁸

3. Parts of the Proposed Interpretation Do Not Accurately Reflect Current Law Regarding Full and Fair Disclosure of Potential Conflicts

Our primary concern with the Interpretation is that it includes provisions that go beyond the Advisers Act and the *Capital Gains* decision, and well beyond the interpretation thereof that has most broadly predominated in the industry for decades. These include the following statements in the proposed Interpretation (in particular where we have added emphasis by italics in the quoted text):

- “The duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape the relationship through contract when the client receives full and fair disclosure *and provides informed consent.*”¹⁹

¹⁵ See Interpretation, n.2, 83 Fed. Reg. at 21204, citing the Code of Ethics and Compliance Program rules, as well as Form ADV amendments.

¹⁶ Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 Vill. L. Rev. 701, at 716 (2010).

¹⁷ Interpretation, 83 Fed. Reg. at 21208 (emphasis added).

¹⁸ We recognize that an adviser’s fiduciary duty, including the duty to provide full and fair disclosure, is made enforceable through section 206 of the Advisers Act, which makes it unlawful for an investment adviser “to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client,” or “to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative.”

¹⁹ *Id.* (emphasis added). We note that Commissioner Peirce stated during the April 18, 2018 open meeting that: “[T]he proposed interpretation makes new law. For example, it states that an adviser and its clients can shape their relationship through disclosure and informed consent. The informed consent requirement is new; the only Commission basis is a mention in an instruction to Form ADV.” Statement at the Open Meeting on Standards of Conduct for Investment Professionals, Comm. Hester M. Peirce (Apr. 18, 2018), available at www.sec.gov.

- “In other words, *the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty.*”²⁰
- “[T]he adviser may violate its fiduciary duty and the antifraud provisions of the Advisers Act if it does not, at a minimum, provide full and fair disclosure of the conflict and its impact on the client and obtain informed client consent.”²¹
- “The duty of loyalty requires an investment adviser to put its client’s interests first. An investment adviser must not favor its own interests over those of a client or *unfairly favor one client over another.*”²²
- “[A]n adviser must serve the *best interests* of its clients...For example, an adviser cannot favor its own interests over those of a client, whether by favoring its own accounts *or by favoring certain client accounts* that pay higher fee rates to the adviser over other client accounts. Accordingly, *the duty of loyalty includes a duty not to treat some clients favorably at the expense of other clients.* Thus, we believe that in allocating investment opportunities among eligible clients, an adviser must treat all clients fairly. This does not mean that an adviser must have a *pro rata* allocation policy, that the adviser’s allocation policies cannot reflect the differences in clients’ objectives or investment profiles, or that the adviser cannot exercise judgment in allocating investment opportunities among eligible clients. Rather, it means that an adviser’s allocation policies must be fair and, if they present a conflict, the adviser must fully and fairly disclose the conflict *such that a client can provide informed consent.*”²³
- “*Disclosure of a conflict alone is not always sufficient to satisfy the adviser’s duty of loyalty and section 206 of the Advisers Act.*”²⁴
- “We believe, however, that it would not be consistent with an adviser’s fiduciary duty to infer or accept client consent to a conflict where either (i) the facts and circumstances indicate that the client did not understand the nature and import of the conflict, or (ii) the material facts concerning the conflict could not be fully and fairly disclosed. For example, *in some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure that adequately conveys the materials facts or the nature, magnitude and potential effect of the conflict necessary to obtain informed consent and satisfy an adviser’s fiduciary duty.* In other cases, disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive. *With some*

²⁰ *Id.* at 21205-21206 (emphasis added). While an adviser’s fiduciary duty cannot be waived, the adviser can disclose or negotiate away, consistent with its fiduciary duty, a requirement to act in a client’s best interest if done in advance and with specificity. Accordingly, we respectfully request the Commission to so clarify this statement.

²¹ *Id.* at 21207.

²² *Id.* at 21208 (emphasis added).

²³ *Id.* at 21208 (footnote deleted).

²⁴ *Id.* (emphasis added). The quoted statement, taken out of context, assumes its own conclusion, in that *insufficient* disclosure will never satisfy the duty.

complex or extensive conflicts, it may be difficult to provide disclosure that is sufficiently specific, but also understandable, to the adviser's clients. In all of these cases where full and fair disclosure and informed consent is insufficient, we expect an adviser to eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed."²⁵

The above statements run contrary to established law. These statements, especially if taken out of context, could be read to suggest that investment advisers have a duty to act in the best interests of clients that cannot be altered by specific, advance disclosure.²⁶

For example, we believe the proposed Interpretation muddies the waters when it states that "in allocating investment opportunities among eligible clients, an adviser must treat all clients fairly." We believe that a proper reading of the Advisers Act and *Capital Gains* would require a different statement. For instance, a private equity firm, properly registered as an investment adviser, that has both a main fund that can invest in investment opportunities worldwide, including in Asia, and a separate fund focused on Asian investments, may appropriately disclose to the main fund investors that the main fund will not receive Asian deals until the Asia fund's desired allocation has been satisfied. Though the main fund might prefer a *pro rata* allocation of Asian deals and such an allocation of the deals away from the main fund may not be in the main fund's best interests, the full and fair disclosure of facts cures the potential breach of fiduciary duty. Unfortunately, such appropriate action by the advisory firm – which we believe is fully consistent with current law when taken in good faith – might be found to run afoul of the proposed Interpretation.

We also respectfully suggest that "informed consent" (as referenced in the excerpts from the Interpretation included above) is surplusage that is likely to confuse matters more than assist. Whether an adviser has provided full and fair disclosure of material facts is a facts-and-circumstances test.²⁷ When the disclosure is targeted to multiple recipients, the test of materiality is an objective test (*i.e.*, based on a hypothetical average member of the client audience to which the disclosure is targeted), including what the hypothetical average member would reasonably be

²⁵ *Id.* at 21209 (footnotes deleted; emphasis added).

²⁶ We also recognize that a significant portion of the Interpretation also emphasizes the importance of disclosure and provides guidance regarding the nature, extent and timing of the disclosure.

²⁷ See *Duties of Brokers, Dealers, And Investment Advisers*, Rel. No. 34-69013; IA-3558; File No. 4-606, note 43 (Mar. 1, 2013): "[T]he Commission acknowledges that existing guidance and precedent under the Advisers Act regarding fiduciary duty turn on the specific facts and circumstances, including the types of services provided and disclosures made."

expected to understand.²⁸ It is not a subjective test, as suggested by the “informed consent” concept.²⁹

Accordingly, we respectfully suggest that the Commission excise references that go beyond the disclosure-based fiduciary duty before considering any subsequent version of the Interpretation.

4. The Interpretation’s Assertion that Advisers Must Use “Will” Instead of “May” Is Overbroad and Potentially Disruptive

Building on a line of reasoning that we have observed in certain public and non-public statements by the Commission staff, the Interpretation states that:

An adviser must provide the client with sufficiently specific facts so that the client is able to understand the adviser’s conflicts of interest and business practices well enough to make an informed decision. For example, an adviser disclosing that it “may” have a conflict is not adequate disclosure when the conflict actually exists.³⁰

We strongly encourage the Commission to refrain from making these types of conclusory statements as to the parsing of particular disclosures if and when it publishes its final guidance. For reasons described below, our experience has been that investment advisers face many instances where the use of “may” is at least as appropriate as “will” when describing conflicts of interest. Even where a conflict currently exists, an adviser may be faced with the recognition that such a conflict may not always persist. In addition, advisers must deal with the practical reality of having to draft conflicts disclosure that will be viewed by a range of current and potential clients in a range of different and specific circumstances. For instance, what may currently present a conflict with one client may, in the future or at present, not result in conflicts that impact a different client.

The use of the word “may” does not necessarily equate to the word “will.” The word “may” can mean “sometimes” and its use is common and well-known and clearly the industry standard. Absent using the word in conjunction with false statements,³¹ the use of the word “may,” in and of

²⁸ See Amendments to Form ADV, Rel. No. IA-3060, note 35 (Jul. 28, 2010): “The standard of materiality under the Advisers Act is whether there is a substantial likelihood that a reasonable investor (here, client) would have considered the information important. See *S.E.C. v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992). Cf. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1988); *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 445, 449 (1976). This is a facts and circumstances test, requiring an assessment of the ‘total mix of information,’ in the characterization of the Supreme Court.”

²⁹ We acknowledge that there are certain matters where disclosure alone is insufficient to waive a conflict. For example, section 206(3) of the Advisers Act prohibits principal trades absent client consent. However, this specific prohibition is outside the scope of the general fiduciary duties of care and loyalty and, of course, section 206(3) allows for informed consent in all instances.

³⁰ Interpretation, 83 Fed. Reg. at 21209 (footnotes omitted).

³¹ See, e.g., *In the Matter of The Robare Group, Ltd., Mark L. Robare, and Jack L. Jones, Jr.*, Securities Exchange Act of 1934 Rel. No. 72950, Admin. Proc. File No. 3-16047, (Sept. 2, 2014). Disclosure that Robare Group “may” receive

itself, is clearly appropriate in order to put clients on notice of the potential conflict and to give them an opportunity to take action in response.

The disclosure required under the Advisers Act does not require advisers to distinguish between conflicts that *have* occurred and those that *may* occur. To interpret the Advisers Act fiduciary duty in such a manner would result in requiring advisers to provide constant amendments to their disclosures, making it extremely difficult, at best, for investment advisers to comply and rendering written disclosures (such as an adviser's brochure) virtually useless.

In any event, if the Commission is intent upon imposing broader prescriptions as to the wording of conflicts disclosure, it should do so through a more formal process, such as rulemaking changes to amend Form ADV. It should not do so through an isolated and conclusory statement contained in a broader interpretive proposal. We respectfully suggest that the proposed Interpretation would be better focused around larger themes that have broad acceptance in existing law, practice and jurisprudence.

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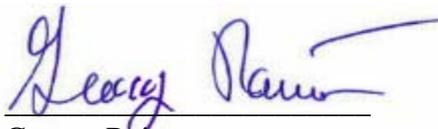
Again, thank you for the opportunity to provide these comments. We stand ready to provide additional comments or to answer any questions you may have.

Given the fact that there are problematic statements in the proposed Interpretation, we respectfully urge the Commission either to (1) amend the Interpretation in a manner that is fully consistent with the Advisers Act and the *Capital Gains* decision, as outlined above; or (2) withdraw the Interpretation formally (if no further Commission action is taken) in order to prevent any further confusion going forward. In addition, we urge the Commission, if and when a final Interpretation is approved, to include a clear admonition that individual statements in the Interpretation should not be cited out of context but rather that the final Interpretation should be read as a whole.

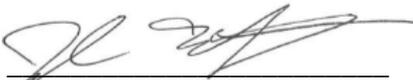
Very truly yours,



Jason E. Brown



George Raine



Joel Wattenbarger

compensation from broker was misleading when coupled with other explicitly false and related statements in the same ADV.