Dechert LLP

1900 K Street, NW
Washington, DC 20006-1110
+1 202 261 3300 Main
+1 202 261 3333 Fax
www.dechert.com

August 7, 2018

VIA E-MAIL

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

Re: Investment Advisers Act Release No. 4889 (File No. S7-09-18): Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

Dear Mr. Fields:

Dechert respectfully submits this letter in response to a request by the Securities and Exchange Commission ("SEC" or "Commission") for comments regarding the proposed interpretation of the standard of conduct for investment advisers ("IA Proposal") under the Investment Advisers Act of 1940, as amended ("Advisers Act") relating to the Commission's views regarding investment advisers' fiduciary duties.[1] We also respectfully submit this letter to respond to the Commission's request for comment on enhancing investment adviser regulation.[2]

We appreciate the SEC's initiative to propose guidance on an investment adviser's fiduciary duty and welcome the opportunity to comment on the IA Proposal. It is crucial that any universal interpretation of an adviser's fiduciary duty be based on sound and time-tested principles. Given the difficulty of defining and encompassing all of an adviser's responsibilities to its clients, while also accommodating the diversity of advisory arrangements, interpretive issues will arise in the future. The IA Proposal and the standards it proposes will be tested further when applied to novel

[1] Dechert LLP is an international law firm with a wide ranging financial services practice that serves clients in the United States and worldwide. Our clients include, among others: registered, exempt and unregistered advisers; banks; broker-dealers; family offices and other financial services organizations serving a wide variety of clients both institutional and retail. We also represent a variety of institutional investors. Thus, our clients include both providers and consumers of investment advisory services. Although we have discussed the proposal and our comments with some of our clients, the comments herein reflect our views and not necessarily the views of our clients.

[2] *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation*, 83 Fed. Reg. 21203 (May 9, 2018).

adviser/client relationships and emerging adviser business models. The great strength of the investment adviser regulatory regime is that it is developed over time by application to specific facts and circumstances. For these reasons, we think that it is advisable that the Commission not define the source or scope of investment advisers' fiduciary duties through a single release such as the IA Proposal, but instead rely on existing authority and sources of law, as well as existing Commission practices for providing interpretive guidance. Therefore, we request that the proposal be withdrawn.[3]

However, if the Commission moves forward, we observe that, unless the standards provide appropriate flexibility to accommodate the vast diversity of advisers and clients, and allow for evolving and differing business models, they will harm advisers and clients, damage the industry, and stymie innovation. If the Commission decides to move forward with a final interpretation and does not withdraw the IA Proposal, we believe that the Commission must address a number of concerns. Our comments below address our concerns and proposed responses with regard to the following aspects of the IA Proposal: (i) statements suggesting that express or implied consent, premised on full and fair disclosure, could ever be insufficient to address material conflicts do not reflect the law and must be removed or, at least, clarified to account for the level of sophistication of the applicable client; (ii) the interpretation should be modified to include the role of the contracting and disclosure process in establishing the contours of an adviser's fiduciary duty; and (iii) the interpretation should explain clearly how advisers should apply the SEC's guidance to their own circumstances taking account differences in client types, business methods, and advisory techniques (particularly those that are novel, non-traditional, or emerging). Finally, we address the SEC's request for comment on three potential areas for enhancing investment adviser regulation. Before we address these primary areas of concern, we offer our observations on the SEC's views on the foundation of the investment adviser fiduciary duty, focusing on (a) the need to recognize state common law as the primary source of an adviser's fiduciary duty and (b) the lack of support cited in the IA Proposal for a federal duty of care. We believe that grounding these foundational concepts in the appropriate authority will ensure that any final interpretation of an adviser's fiduciary duty can be consistently and appropriately applied across the industry.

I. The IA Proposal lacks support for the SEC's assertion that there is a federal fiduciary duty for advisers and should instead recognize state common law as the source of an adviser's fiduciary duty.

Predating the Advisers Act, advisers (as agents) owed fiduciary duties under the common law to their clients (as principals). Any interpretation of an investment adviser's fiduciary responsibilities

[3] Given that the proposal was cast as "clarifying" and "reaffirming" existing positions, such withdrawal should make clear that the IA Proposal should not be granted precedential value.

should recognize that state common law (in particular, the law of agency) is the source of an adviser's fiduciary duty. Fiduciary duties fundamentally flow from a principal/agent relationship, in which the client (as principal) delegates some set of responsibilities to the fiduciary (as agent), which the agent has to accept in order to have fiduciary duties.[4] A person cannot have fiduciary duties unless and until it has agreed to accept a fiduciary position.

Rather than grounding the IA Proposal in this common law foundation, the SEC cites two primary sources in asserting that advisers are subject to a "federal" fiduciary duty: Section 206 of the Advisers Act and a misinterpretation of *SEC v. Capital Gains*,[5] as well as a variety of other sources such as treatises and prior SEC releases, including one for which comments provided were unaddressed because the rulemaking was abandoned.[6]

The SEC's reliance on these precedents is misplaced. Congress, in enacting Section 206, *recognized* that advisers are fiduciaries under state law and intended that the SEC would police conflicts of interest by bringing enforcement actions where they were not disclosed,[7] and exercise rulemaking authority, including under the anti-fraud provisions of the Advisers Act, with respect to disclosure and substantive obligations. Congress intended that the shine of sunlight through full disclosure would have the effect of eliminating and/or mitigating conflicts of interest that did not benefit investors.

Capital Gains acknowledges that advisers are fiduciaries under state law, but the case itself does not hold that the Advisers Act *imposes* federal fiduciary duties of care or loyalty on advisers, nor does it hold that such duties arise from anywhere other than common law. *Capital Gains* is an important case in shaping the body of case law on fiduciary duty, but references in *Capital Gains* to fiduciary duties should not be misinterpreted to indicate that Section 206 imposes a comprehensive fiduciary duty on advisers. In *Capital Gains* the Court applied Section 206 to

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[4] *See* Restatement (Third) of Agency, § 8.08 ("Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.").

[5] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

[6] *Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients*, 59 Fed. Reg. 13464 (Mar. 22, 1994).

[7] *Capital Gains*, 375 U.S. at 195 ("…it would be logical to conclude that Congress codified the common law "remedially" as the courts had adapted it to the prevention of fraudulent securities transactions by fiduciaries"); *See Investment Trusts and Investment Companies: Hearing on S. 3580 Before the S. Comm. on Banking and Currency*, 76th Cong. 996-1004 (1940) (statement by David Schenker, Chief Counsel, Investment Trust Studies of the Securities and Exchange Commission) (submitting a report entitled "State Regulation of Investment Counsel Firms," which outlines state regulations applicable to investment advisers, including any fiduciary obligations). In addition, the IA Proposal acknowledges that "the antifraud provisions of the Advisers Act [are] enforceable by the Commission for breaches of fiduciary duty in the absence of full and fair disclosure." IA Proposal, 83 Fed. Reg. at 21214.

enforce state fiduciary duties by making clear that actions that might conflict with such duties as commonly understood must be disclosed so that the principal may determine whether to accept the agent's services on those terms. The Court also sought to make clear that Section 206 can be read to align with the existing state common law fiduciary duty of full and fair disclosure. Indeed, the Court did not find that the scalping[8] activity engaged in by the defendant breached a substantive federal obligation, but rather that the violation was in the adviser's failure to inform investors they would be used to influence stock prices to the adviser's likely advantage and the client's possible detriment, thus to inform them that the defendant intended to act in a manner that conflicts with its state law fiduciary duties.

The IA Proposal also references *Transamerica v. Lewis*,[9] among other cases, to support the statement that the "Advisers Act establishes a federal fiduciary standard for investment advisers." While the Court in *Transamerica* references federal fiduciary obligations, such references should be read within the context of that case in which the Court focused on determining whether there was a private right of action under the Advisers Act. Relying on general references to an adviser's "federal fiduciary duty" in a Supreme Court case where the issue before the Court was whether a private right of action exists, does not provide a solid foundation for establishing an adviser's fiduciary duty going forward. Further, *Transamerica* does not include any analysis or application of an adviser's fiduciary obligations. Rather, references in *Transamerica* to a "federal fiduciary duty" are mere dicta and not part of the Court's reasoning. Because the Court in *Transamerica* does not rely on the premise that there is a federal fiduciary duty in order to reach its holding and because the Court in *Capital Gains* does not reason to that conclusion in order to address the issue before the Court in that case, the SEC cannot use such statements to create a federal fiduciary duty.

Another case the IA Proposal cites, *Santa Fe v. Green*, focuses on whether Section 10(b) of, and Rule 10b-5 under, the Securities Exchange Act of 1934 ("Exchange Act") support the existence of a federal corporate fiduciary duty. While this case discussed certain disclosure issues in the context of a corporate merger, any references in this case to an adviser's fiduciary duty are ancillary and instead bolster the argument that the linchpin of an adviser's fiduciary obligations is in fact disclosure.[10] References in *Santa Fe* to fiduciary responsibilities focus on disclosure and misrepresentations as requirements for establishing a breach: "…the cases [cited by the respondents] do not support the proposition, adopted by the Court of Appeals below and urged by respondents here, that a breach of fiduciary duty by majority stockholders, without any deception,

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[8] *See infra* footnote 20.

[9] *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979).

[10] *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 471, n.11 (1977) (recognizing that the Advisers Act addresses an adviser's disclosure failures and that "the fraud that the SEC sought to enjoin in *Capital Gains* was, in fact, a nondisclosure.")

misrepresentation, or nondisclosure, violates the statute and the Rule."[11] Ironically, the SEC cites *Santa Fe*, which stands for the proposition that the federal securities laws do not impose fiduciary duties on corporations, to support the SEC's position that dicta in *Santa Fe* supports a "federal fiduciary duty".[12]

As dicta, the statements in *Santa Fe* and *Transamerica* pertaining to a federal fiduciary duty must be read as narrowly as possible. Placing these dicta in the context of *Capital Gains*, which discusses an adviser's fiduciary duty in the context of Section 206 anti-fraud provisions, the best interpretation of these dicta is that they refer to an adviser's federal duty of disclosure.

Moreover, even settled SEC enforcement actions under the Advisers Act anti-fraud provisions consistently rest on the legal theory that the defendant has failed to disclose its breach of duty or other bad actions rather than on theories premised on such actions violating a duty other than the duty to disclose. As a result, statements in the IA Proposal that an adviser's fiduciary duty "is established under federal law"[13] should instead state that an adviser's fiduciary duty originates in state law and is grounded in the concepts of principal/agency law and the law of trusts and that Section 206 of the Advisers Act imposes an obligation to disclose activities that might conflict with state law fiduciary duties. In doing so, the SEC should clarify that the state law foundation of the fiduciary duty can be enforced at the federal level, to the extent it falls within the ambit of the Advisers Act (particularly, Section 206), as was the case in *Capital Gains* and the many other disclosure cases cited by the SEC in the IA Proposal.

We believe that it is critical that any final interpretation be well grounded in authoritative precedent and the principles on which that precedent is based rather than a selective collection of dicta, unadopted rules, cases that are founded on disclosure (not violations of a purported federal duty), and academic treatises. Therefore, we suggest that the SEC remove all references to a "federal fiduciary duty" and instead ground its interpretation on state common law as the origin of an adviser's fiduciary duty, discuss federal interpretations of the fiduciary duty (*Capital Gains*), and recognize the Section 206 anti-fraud provisions as the enforcement mechanism. We believe that this approach is respectful of precedents while still allowing for useful industry guidance. If Congress desires to establish or define a federal fiduciary duty for advisers, Congress can pass legislation to do so.

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[11] *Santa Fe*, 430 U.S. at 476.

[12] *Id*. at 479.

[13] *See also*, other statements in the release that recognize a federal fiduciary duty: "the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act" and "[t]he Advisers Act establishes a federal fiduciary standard for investment advisers". IA Proposal, 83 Fed. Reg. at 21204-05.

II. The IA Proposal does not include sufficient support for the SEC's assertion that there is a federal *duty of care*.

According to the IA Proposal, an adviser's fiduciary duty under the Advisers Act consists of two components: a duty of care and a duty of loyalty. However, none of the sources cited (treatises, *Capital Gains*, SEC releases, law review articles, and the SEC's 1994 *Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients* proposal ("1994 Suitability Proposal")) in the IA Proposal address a duty of care that is independent of an adviser's disclosure obligations under the Section 206 anti-fraud provisions.

The IA Proposal cites *Capital Gains*, other case law, and an administrative proceeding as support for the existence of a federal duty of care. However, *Capital Gains* does not explicitly reference a "duty of care" but instead focuses on whether the Advisers Act requires disclosure of a practice that disadvantages clients.[14] Even outside of the duty of care discussion in the IA Proposal, each of the cases cited in the IA Proposal is premised on a theory of failure to disclose. We are not aware of a single federal case holding that the Advisers Act imposes a "duty of care". Likewise, the administrative proceeding cited in the IA Proposal does not reference a "duty of care" but, instead, is similarly based on an adviser's failure to satisfy disclosure obligations.[15]

What little SEC guidance there is on an adviser's duty of care has arisen in the context of rulemakings under Section 206(4), which authorizes the SEC to adopt anti-fraud rules. For example, the IA Proposal cites to the adopting release for the proxy voting rule to support the SEC's assertions that investment advisers owe a duty of care.[16] However, references to a "duty of care" in that release are limited to the context of proxy voting and do not support a broader duty of care for advisers that is applicable in other contexts.[17]

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[14] *Capital Gains*, 375 U.S. at 196-197 ("Courts 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.").

[15] *In the Matter of Larry C. Grossman*, Investment Advisers Act Release No. 4543 (Sep. 30, 2016) (Commission opinion) (finding violations of investment adviser anti-fraud provisions based on the adviser's undisclosed conflicts of interest and misrepresentations and omission of material facts; determining that "despite a fiduciary duty to Sovereign clients, [Grossman] failed to ensure that Sovereign complied with other Advisers Act regulations related to client disclosures and custody of client assets.").

[16] IA Proposal, 83 Fed. Reg. at 21205.

[17] *Proxy Voting by Investment Advisers*, 68 Fed. Reg. 6585, 6586 (Feb. 7, 2003) (Discussion of the duty of care is limited to the repetition of the following concept: "The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies.").

Narrow references to a purported federal duty of care as applied in the proxy voting context are insufficient to support another prong of an adviser's fiduciary duty (the duty of care) that would apply to all aspects of an adviser's relationship with its client. The SEC also cites the never-adopted 1994 Suitability Proposal as support for a federal fiduciary duty of care. We believe that releases from proposed rules in general, and proposed but never adopted rules in particular, are insufficient expressions of SEC views to serve as a basis for such a novel reinterpretation of the fiduciary duties of investment advisers. We caution against reliance on the 1994 Suitability Proposal as support for an adviser's duty of care as the 1994 Suitability Proposal is merely a preliminary statement by the Commission, which was not tested by notice and comment. As such it should not be seen as authoritative precedent. We note particularly that the suitability rule was not adopted and that the IA Proposal never even discusses any comments received in response to the 1994 Suitability Proposal or any statement of the Commission on such comments. Indeed, the fact that the 1994 Suitability Proposal was never adopted could and, perhaps, should be viewed as an indication that the SEC, at the time, changed its view in light of the comments received. Similarly the IA Proposal on which we are commenting should not be cited as authoritative precedent if an interpretation of the fiduciary duty becomes final, or if no subsequent or final release is issued.

For these reasons, we suggest that any final guidance not include references to the 1994 Suitability Proposal and that the SEC clarify that its views on an adviser's duty of care, if included in a final interpretation, are based on state common law rather than on federal case law and administrative proceedings.

III. Statements in the IA Proposal that an adviser, in certain circumstances, may need to *eliminate* material conflicts of interest are contrary to (a) the current application of Section 206, (b) federal courts' interpretations of an adviser's fiduciary duty, and (c) the industry's current understanding regarding the sufficiency of disclosure.

We believe that statements in the IA Proposal that there are conflicts that an adviser may need to eliminate (rather than mitigate and/or address through disclosure) misstate the law, as articulated by the Supreme Court[18] and as applied by practitioners for over 50 years. The anti-fraud provisions of Section 206 have long been interpreted to require an adviser to disclose, but not eliminate, conflicts of interest. Section 206 is the only available cause of action under the Advisers Act against

[18] The IA Proposal cites three Supreme Court cases, none of which require an adviser to eliminate material conflicts of interests and one of which relates to conduct under an entirely different statute. Each recognizes the requirement to disclose conflicts of interest, however two of the cases focus on unrelated issues. *Capital Gains*, 375 U.S. at 197 (holding that full and fair disclosure is required by Section 206 of the Advisers Act); *Transamerica*, 444 U.S. at 11 (holding that the Advisers Act does not create a private right of action under Section 206 of the Advisers Act); *Santa Fe*, 430 U.S. at 463 (holding that only conduct involving manipulation or deception is reached by Section 10(b) of, or Rule 10b-5 under, the Exchange Act).

an adviser for violating his/her fiduciary duty. Notably, SEC enforcement orders, which are statements of the Commission itself, repeatedly indicate that violations are for not disclosing conflicts, consistently indicating the Commission's recognition that any breach of the anti-fraud provisions must be disclosure-based.[19] As discussed above, the fundamental premise of *Capital Gains*, which is clearly and plainly stated by the Court, is that the Advisers Act requires disclosure of material conflicts, but does not require the elimination of such conflicts.[20]

Advisers for at least the past 50 years have been operating under the understanding that providing adequate disclosure of material conflicts of interest and obtaining informed consent (whether implied or explicit) is always sufficient to discharge their obligations with respect to conflicts of interest. Still, advisers have recognized that, in certain circumstances, material conflicts may need to be mitigated before they can be adequately disclosed or before such disclosure will be judged acceptable by advisers and clients. Now, the SEC proposes to adopt the novel and much more rigid interpretation that "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."[21] In our view, full and fair disclosure and informed implied or explicit consent is always sufficient to satisfy an adviser's fiduciary duty to its client with respect to conflicts of interest; the question is whether particular disclosures provided meet the "full and fair" standard and are sufficiently clear to allow consent to be "informed".[22] To do as the SEC now appears to be proposing would disrupt the advisory industry by (i) causing advisers to unnecessarily change their business models or eliminate certain services, practices or approaches to providing investment

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[19] *See e.g.*, *In re WCAS Management Corporation*, Rel. No. 4896 (Apr. 24, 2018) (determining that respondent's "disclosure failure regarding conflicts of interest" between an investment adviser and its client resulted in a violation of Section 206(2) of the Advisers Act); *In re Lyxor Asset Management, Inc.*, Rel. No. 4932 (Jun. 4, 2018) (finding that respondent's "failure to disclose conflicts of interest" between an investment adviser and its clients resulted in a violation of Section 206(2) of the Advisers Act); *In re TPG Capital Advisors, LLC,* Rel. No. 4830 (Dec. 21, 2017) (determining that an investment adviser's inadequate disclosure of a conflict of interest "involved a breach of fiduciary duty" that resulted in a violation of Section 206(2) of the Advisers Act).

[20] In *Capital Gains*, a registered investment adviser and its personnel engaged in a practice called "scalping" whereby they traded on the market effect of their own recommendations without disclosing such activity to clients. The advisers purchased certain securities for their own accounts and advised their clients to buy those same securities without disclosing the registered investment advisers' positions. When the market price of the securities rose, the advisers sold their shares at a profit. The Court held that these actions were permissible as long as the advisers made "full disclosure of the practice to [their] clients." *Capital Gains*, 375 U.S. at 180.

[21] IA Proposal, 83 Fed. Reg. at 21209.

[22] Stated differently, there is always some level of disclosure that would be sufficient and there is no conflict so severe that it is inherently unable to be addressed through disclosure. However, the actual disclosure provided, and the level of sophistication of the client, may reveal that particular disclosures are, in fact insufficient. In this case, an adviser can: (1) improve disclosure; (2) limit the product/practice to more sophisticated clients; (3) mitigate the practice; or (4) eliminate it.

advice; (ii) causing advisers to limit the products and services they offer; and (iii) changing the way that advisers interact with clients, which could lead to investor confusion.[23]

If the IA Proposal is adopted in its current form, advisers will constantly be concerned that the SEC or its Staff may later judge that disclosure alone was not sufficient to ameliorate a particular type of conflict associated with their business based on a determination about that conflict on an industry-wide level. This would have a profound negative impact on the availability of quality advice, particularly for nontraditional, novel or emerging asset classes, strategies, methods and products. For example, an adviser rolling out a new product that combines digital advice with direct contact with an adviser while allowing for smaller account sizes may be concerned that the Staff might take the position that a conflict necessarily attendant to offering or delivering the product was one for which disclosure alone is not sufficient. Without guidance from the SEC or the industry, advisers may decide to refrain from offering these sorts of novel products or to limit the offering to clients that meet certain standards or requirements (for example, based on assets) even though their services could benefit a broad cross section of the investing public. Advisers may also decide to limit product offerings and services in order to alleviate the compliance burden associated with determining which products/services might be deemed to require elimination instead of disclosure. Instead of protecting investors, the adoption of the interpretation as proposed could lead to clients receiving fewer investment opportunities, access to fewer products, and exposure to less educational information. If advisers are concerned that certain conflicts can never be adequately disclosed, and, particularly without advance warning as to which conflicts the SEC or its Staff would view to fall within that category, instead of enhancing existing disclosure in order to address conflicts, advisers may decide to eliminate certain business and product lines or no longer service certain client types. As discussed below, we instead support an interpretation that recognizes and accounts for the sophistication levels of both retail and institutional clients.

Any interpretation that fails to draw the line between elimination and mitigation/disclosure based on anything other than the actual sufficiency of particular disclosure in the full context of the applicable circumstances will disrupt the industry and will result in advisory firms looking to each other, rather than to regulatory authorities, for practical guidance, which may impair innovation. We support an interpretation that accounts for investor sophistication at both the retail and institutional levels. Such an interpretation must allow for every adviser to reasonably determine, in context, the level of disclosure that is sufficient to allow for informed consent (whether express

[23] For example, if the SEC's proposed interpretation was adopted and advisers who had previously provided clients with adequate disclosure of material conflicts to existing clients had to eliminate certain types of advice/products that such clients had been happily receiving, such clients would likely be confused and may lose access to valued services. Alternatively, advisers might feel compelled to provide clients with overly lengthy and complex disclosures that are less useful to clients and limit the ability of clients to reasonably compare the disclosures of advisers with which they are considering investing.

or implied) by its clients. This gives agency to advisers and clients to establish a relationship and be informed consumers and service providers, and promotes a healthy and innovative advisory marketplace. Advisers that service both retail and institutional clients would be able to determine which types of products/services are appropriate for each client type, while also considering the sophistication level of both retail and institutional clients and clients would be empowered to select an adviser whose services meet their needs.

It is also unclear how advisers would apply the IA Proposal to existing client relationships. For example, would advisers need to reassess all of their lines of business and advisory agreements to determine whether appropriate disclosures were made commensurate with the client's level of sophistication and the scope of the relationship?

As a solution, we recommend that the SEC clarify certain statements in the IA Proposal to align with current industry practice, acknowledge the sufficiency of clear disclosure of material conflicts of interest combined with informed consent, and recognize that an adviser may choose to mitigate a conflict to make disclosure more manageable. Any final interpretation must not cast elimination as a separate, binary option to mitigation, but that instead should discuss potential elimination of a conflict as existing on the far end of the spectrum of mitigation, to be used only where sufficient disclosure is not a practical option even with mitigation. Such an interpretation would recognize that advisers weigh factors, including the client sophistication and scope of the advisory relationship, when providing investment advice and determine whether a conflict is adequately disclosed without mitigation, whether mitigation combined with disclosure is the better approach or whether the practice is one that the adviser does not feel confident offering.

IV. The IA Proposal does not sufficiently recognize that whether an adviser has provided sufficient disclosure to allow a client to provide informed consent depends on the relationship between the adviser and the client. The advisory contract defines the advisory relationship and establishes the scope and nature of an adviser's fiduciary duty to a particular client.

The IA Proposal states that, in some cases, full and fair disclosure and informed consent *may be insufficient* to address an adviser's material conflict of interest.[24] As discussed above, we disagree and submit that the general view has always been that full and fair disclosure plus informed consent

[24] IA Proposal, 83 Fed. Reg. at 21209.

can address *all* material conflicts.[25] We discussed the sufficiency of disclosure above and here we address informed consent.[26]

The IA Proposal acknowledges that the fiduciary duty "follows the contours" of the client relationship that is shaped by the advisory contract and all disclosures to which a client provides informed consent. We believe that an adviser can satisfy its fiduciary obligations by fully disclosing material conflicts and obtaining the client's informed consent in all cases. We also believe that an advisory contract that establishes the terms of the relationship and expectations of the client does not represent an adviser contracting away its fiduciary duties under the contract. However, we agree with the Commission that a contract purporting to waive the adviser's fiduciary duties generally (*e.g.*, a covenant that the adviser "shall not be acting as a fiduciary") or any specific obligations under the Advisers Act would be inconsistent with the Advisers Act.

As an illustration of how the advisory contract establishes the terms of the relationship and the expectations of the client and thereby impacts the nature and scope of duties owed thereunder, consider an adviser's ongoing duty to monitor a client's portfolio. According to the IA Proposal, "[a]n adviser's duty to monitor extends to all personalized advice it provides the client, including an evaluation of whether a client's account or program type…continue to be in the client's best interest."[27] In the IA Proposal, the SEC recognizes that a client has the ability to hire an adviser for a flat fee for one-time advice and that a client also has the ability to hire an adviser for an ongoing fee to provide continuing advice and monitoring. However, the SEC, in the statement quoted above, clearly overstates the monitoring responsibilities of an adviser who provides personalized advice for a flat fee. It is unclear how an adviser providing one-time advice for a flat fee would have any monitoring obligation, even if that advice is personalized or what the relevance would be to the client of the adviser's "evaluation of whether a client's account or program type . . . continue to be in the client's best interest." Even with an ongoing fee, an ongoing review may not be what the client wants or is willing to pay for and, provided that the contract clearly states that no ongoing review, or limited ongoing review, is expected, the Advisers Act should not require more than the client has bargained for.

We suggest that the SEC make the revisions in the chart below and discuss the monitoring obligation as part of the "services" an adviser provides to clients as opposed to as a separate obligation that all advisers owe all clients. An interpretation that does not acknowledge the complexity of the client relationship and instead suggests that all advisers have a monitoring

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[25] *See supra* footnote 22.

[26] The IA Proposal states that, in some cases, full and fair disclosure and informed consent *may be insufficient* to address an adviser's material conflict of interest. IA Proposal, 83 Fed. Reg. at 21208-09.

[27] IA Proposal, 83 Fed. Reg. at 21208.

obligation, regardless of their business models or client relationships, will not only cause confusion, but will result in an interpretation that includes contradictory statements (on the one hand, that the advisory agreement establishes the contours of the relationship and on the other hand all advisers have an ongoing monitoring obligation). For example, not clarifying the scope of the monitoring obligation could result in confusion among advisers to retail clients as to whether such advisers must review all client accounts upon a change in the U.S. Tax Code even where not all advisory agreements require the adviser to provide ongoing advice or where the contract provides that tax status will not be considered. A failure to recognize the dynamism of the advisory contract, the role it plays in shaping the client/adviser relationship, and the flexibility it affords both advisers and clients would not align with current industry practice and would not achieve the goal of increasing investor protections or maximizing investor choice of products and services.

Whether a client has provided informed consent depends on several factors including the sophistication of the client and the terms of the advisory agreement, and thus we also encourage the SEC to refrain from including in its guidance a prescriptive process that advisers must adopt in order to obtain informed consent, whether implicit or explicit: the SEC should not require an adviser to obtain explicit consent for certain types of material conflicts. Instead, advisers should be permitted to rely on their judgment and knowledge of the specific client relationship to determine (i) whether a client has provided informed consent to a material conflict of interest and (ii) whether client consent is implicit or explicit. To illustrate with the example discussed above, our view is that an adviser has received informed consent where a client has entered into its advisory contract in which an adviser agrees to provide one-time advice for a flat fee or limited scope of services and that the adviser will not monitor the client's account on an ongoing basis.

To address the issues identified in Section III and this Section IV, we propose at a minimum the following adjustments to language in the IA Proposal:

IA Proposal	Revision
"Disclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers Act."[28]	An adviser can satisfy its duty of loyalty and Section 206 of the Advisers Act by providing full and fair disclosure of any material conflicts of interest. In some cases, advisers may seek to mitigate or can eliminate such conflicts to manage their disclosure obligations.
"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	An adviser must disclose a material conflict of interest in a manner such that a client can understand the conflict in order that its engagement

[28] IA Proposal, 83 Fed. Reg. at 21208.

IA Proposal	Revision
mitigate the conflict so that it can be more readily disclosed."[29]	of the adviser or continued use of the adviser's services would represent informed consent. In certain cases, an adviser may seek to first mitigate a material conflict of interest so the conflict can be disclosed in a manner that would more readily allow a client to provide informed consent. An adviser cannot simply tell a client that the adviser will not be loyal, but must instead disclose to a client with a reasonable degree of specificity conflicts and the potential negative impacts on the client.
"An investment adviser's duty of care also encompasses the duty to provide advice and monitoring over the course of a relationship with a client."[30]	The relationship between the adviser and client is determined by contract, which establishes the contours of the relationship and any resulting duties, including the type and frequency of the advice provided. It may, but does not necessarily, require ongoing services or monitoring.
"An adviser is required to provide advice and services to a client over the course of the relationship at a frequency that is both in the best interest of the client and consistent with the scope of advisory services agreed upon between the investment adviser and the client."[31]	An adviser is required to provide advice and services to a client over the course of the relationship, as detailed in the investment advisory agreement between the adviser and client. Such advice and services must be provided at a frequency that is in the best interest of the client viewed within the scope of the advisory services agreed upon between the investment adviser and the client. An example of how the advisory agreement can limit the scope of services an adviser provides to its client is where a client hires an adviser to manage a bond portfolio but not to advise on how much of the client's greater portfolio should be invested in bonds.
"The duty to provide advice and monitoring is particularly important for an adviser that has an ongoing relationship with a client (for example, a relationship where the adviser is compensated with	An adviser with a continuous relationship with a client (for example, a relationship where the adviser is compensated with a periodic asset-based fee or an adviser with discretionary authority over client

[29] *Id.* at 21209.

[30] *Id.* at 21207-08.

[31] *Id.* at 21208.

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a periodic asset-based fee or an adviser with discretionary authority over client assets). Conversely, the steps needed to fulfill this duty may be relatively circumscribed for the adviser and client that have agreed to a relationship of limited duration via contract (for example, a financial planning relationship where the adviser is compensated with a fixed, one-time fee commensurate with the discrete, limited-duration nature of the advice provided)."[32]	assets) has a duty to provide ongoing monitoring within the scope of the agreed upon services. In contrast, an adviser and client that have signed an agreement establishing a relationship of limited duration or scope (for example, a financial planning relationship where the adviser is compensated with a fixed, one-time fee commensurate with the discrete, limited-duration nature of the advice provided) would not necessarily, and generally will not, have the same monitoring obligation. While fees may be reflective of services and expectations, clear contract language governs such that not every adviser that charges an asset-based fee is offering the same services or the same level of monitoring. These examples lay at two ends of the spectrum and advisers and their clients may and will establish customized arrangements at different points along this spectrum.

V. The IA Proposal does not sufficiently describe application of an adviser's fiduciary duty for advisers servicing institutional clients.

The SEC's standard of conduct package of proposals, consisting of Regulation Best Interest,[33] Form CRS,[34] and the IA Proposal, is primarily aimed at improving protections for retail investors and customers. Of the three releases, only the IA Proposal seems to apply to institutional investors, making the application of this guidance more nuanced and complicated for many advisers serving the institutional market (whether exclusively or in combination with servicing retail clients). Advisers serving primarily or exclusively retail clients often face different challenges than those working primarily or exclusively with institutional investors. The SEC has recognized this distinction in other areas of adviser regulation,[35] and the federal securities laws also treat

[32] *Id.*

[33] *Regulation Best Interest*, 83. Fed. Reg. 21574 (May 9, 2018).

[34] *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles*, 83 Fed. Reg. 21416 (May 9, 2018).

[35] For example, Advisers Act Section 205(a)(1) prohibits investment advisers from entering into an investment advisory contract with performance-based fees. However, Advisers Act Rule 205-3 recognizes the concept of a "qualified client" and allows an adviser to enter into an advisory contract with a performance-based fee with certain "qualified clients". Also, Section 205(b)(4) excepts from the prohibition in Section 205(a)(1) "an investment advisory contract with a

sophisticated investors differently.[36] We believe it is important to recognize the different challenges advisers will face in applying the fiduciary standard in the IA Proposal to retail and institutional investors, and provide guidance as to how advisers may address those challenges. We also note that it is important to recognize that a certain level of sophistication should not be presumed for an institutional client, nor should all retail clients be presumed to lack sophistication.

Advisers to institutional investors work directly with sophisticated clients and private fund investors who are, in many cases, well-positioned to understand and negotiate the terms of an advisory relationship in detail. Of course, many retail clients are also sophisticated and capable of understanding and negotiating an advisory agreement that is tailored to their specific investment needs. Because sophisticated investors already understand complex conflicts of interest and are more likely to hire an adviser to provide recommendations on a narrow investment type or strategy or for a less traditional service, advisory method, or asset class that may be more complex or prone to conflict, greater clarity should be provided to allow advisers and clients to have the lead role in determining whether informed consent has been granted in this context. Any guidance that does not recognize and is not sufficiently broad to accommodate the application of concepts in the IA Proposal to sophisticated clients (whether "retail" or "institutional") risks changing the institutional marketplace for investment advice and potentially limiting investment opportunities for sophisticated clients. The result could be increased compliance burdens for advisers with sophisticated clients or the decay or disappearance of certain nontraditional advice or methods for clients who want such advice and a chilling effect on innovation.

We recommend that the SEC include specific examples of how the fiduciary duty applies to advisers with institutional clients and how it applies to sophisticated retail clients.

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company excepted from the definition of an investment company under [S]ection 3(c)(7)". Notably, funds covered by Section 3(c)(7) of the Investment Company Act of 1940 ("1940 Act") include many hedge funds, which are primarily marketed to wealthy and sophisticated investors satisfying the definition of a qualified purchaser. Section 205(e) also allows the Commission to provide an exemption from Section 205(a)(1) upon a determination that a person does not require protections afforded by Section 205(a)(1) based on factors including but not limited to a person's "financial sophistication, net worth, knowledge of and experience in financial matters, amount of assets under management, relationship with a registered investment adviser".

[36] For example: Rule 501(a) of the Securities Act of 1933 ("Securities Act") exempts offers and sales to "accredited investors" from Securities Act registration; Rule 144A permits the resale of restricted securities to "qualified institutional buyers" (as part of a safe harbor from registration requirements) under the Securities Act; Section 2(a)(51)(A) of the 1940 Act defines "qualified purchasers"; Section 3(a)(54) of the Exchange Act defines "qualified investors"; and Section 1a(18) of the Commodity Exchange Act of 1936 defines "eligible contract participant" to include an individual with certain amounts invested on a discretionary basis. *See generally*, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015), available at https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf.

Possible examples include:

- A sophisticated retail client seeks to engage an adviser to opine on stock investments where the client, through initial research and due diligence, has narrowed the investment selection to three different companies and has not requested comprehensive advice on the remainder of the client's portfolio (*i.e.*, retirement assets, fixed-income investments). Because this client only seeks one-time advice within this narrow scope, its adviser should not be required to provide, nor should the client be required to receive, ongoing monitoring of these companies or the adviser's analysis of whether more comprehensive services would be more appropriate.
- A sophisticated institutional client hires an adviser to invest the equity sleeve of the institution's assets. This client does not request or require advice on diversification, but would expect to receive ongoing monitoring services as to that equity sleeve.
- Some advisers are, or are related to, institutions that invest for their own accounts (often by originating private equity or debt investments, which are inherently of limited liquidity). Clients, particularly sophisticated institutional clients, may seek out these advisers to participate alongside them (or their affiliate) in their deals and expect or explicitly require through contracts or investment policy statements that the client will participate only in opportunities that are also held by the adviser or its affiliates. Such advisers may be alarmed by the language regarding allocations in the proposal which, we believe, may have inadvertently failed to fully take into account the allocation of an investment to the adviser or an affiliate and could be read to suggest that advisers cannot be allocated an investment alongside clients (although we have long believed that such a practice is permissible). Clients should be able to receive, and advisers provide, this sort of service. Sophisticated clients should able to understand potential conflicts through good disclosure provided to them and should be able to consent to an arrangement where the allocation policy is such that the adviser or its affiliate is able to participate alongside clients on a pro rata basis and, if agreed by the clients, on a basis that is other than pro rata (even though such an allocation methodology may not be consistent with the duty of loyalty absent such disclosure). Any interpretation should make clear that, where the allocation methodology, any preferences inherent therein, and the impact on clients are fully and fairly disclosed, an adviser should be free to employ allocation methodologies that fit the advisory engagement without being accused of having breached a fiduciary obligation. Absent such clarification, advisers may determine to no longer provide these types of investment advisory services, thus depriving investors of the opportunity to participate in such investments.

VI. The SEC should not pursue enhanced regulations for advisers in the areas of federal licensing and continuing education, provision of account statements, and financial responsibility.

The Commission is considering enhancing three areas of adviser regulation in order to further harmonize the regulation of advisers and broker-dealers. Primarily due to the differences between adviser and broker-dealer regulatory regimes, we believe that enhancements to adviser regulations are not needed in these three areas, as discussed below.

a. Federal licensing and continuing education: The SEC is considering imposing federal licensing and continuing education requirements on personnel of SEC-registered investment advisers, as discussed in the Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Act ("Section 913 Dodd-Frank Study"). In addition to the concerns raised in this study,[37] there are three reasons why we believe that such requirements should not be extended to advisers.

First, Congress allocated investment adviser representative licensing to the states such that imposing adviser representative licensing and education at the federal level would be duplicative and inconsistent with the statutory scheme. Second, as the Staff recognized in the Section 913 Dodd-Frank Study, the regulatory regimes surrounding advisers and broker-dealers are different: one is principles-based while the other rules-based.[38] Given these fundamental differences, attempting to institute parallel regulations could disrupt these regulatory frameworks. Third, broker-dealer and adviser functions and business activities are distinct: advisers can be highly specialized, focusing on only certain markets or types of investments. Any exam that the SEC would create would not be able to adequately cover the specialty areas of advisers and therefore would fall short of ensuring high professional standards and increased investor protection, which is the stated purpose of the package of proposals.

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[37] Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act at 86-87, 138 (Jan. 2011) ("[t]he lack of a continuing education requirement and uniform federal licensing requirement for investment adviser representatives may be a gap, but establishing such requirements for investment adviser representatives may raise certain challenges for the Commission, given the current lack of infrastructure and resources to administer an education and testing program. The Staff notes, however, if these requirements were imposed, a private organization could develop the program"), available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf.

[38] *Id.*

b. Provision of account statements: The SEC is considering requiring advisers to directly or indirectly provide account statements. We do not support such a proposal for two reasons.

First, Rule 206(4)-2 under the Advisers Act (the Custody Rule) already requires that an adviser or custodian provide account statements in certain circumstances.[39] Second, proposed Form CRS is designed to help investors obtain the fee, expense, and other information necessary to make informed decisions about investment professionals. This proposed form requires disclosure of information that would allow an investor to compare fees and includes a list of questions that customers can ask their adviser/broker-dealer. As a result, Form CRS provides investors with the platform and tools necessary to make informed investment decisions. While the discussion in the IA Proposal focuses on the benefits to retail customers, the SEC does not state that any requirement to provide account statements would be limited to retail clients. Requiring advisers to provide periodic account statements is unnecessary and would burden advisers with institutional clients, a group the SEC does not appear to be targeting in this retail customer-centric package of proposals.

c. Financial responsibility: The SEC is considering requiring advisers to comply with net capital and fidelity bonding requirements, among other requirements imposed on broker-dealers, to guard against financial insolvency. For several reasons, we believe that such restrictions are unnecessary for advisers.

First, advisers are acting as agents and not as principals, as do broker-dealers in certain circumstances, making it unnecessary to carry over such requirements. Second, it is unlikely that, even if an adviser maintained net capital, such amounts would be sufficient to cover any investor losses. We are not aware of circumstances where clients have been harmed by an inadequately capitalized adviser where any reasonable level of statutory capital would have had a significant impact. Indeed, the IA Proposal does not cite to any such occurrences. Also, requiring an adviser to hold capital in reserve means that an adviser is not fully utilizing all available resources. Third, a high net capital requirement would create a barrier to entry and would prevent new advisers from entering the profession, which could stifle innovation and limit avenues for investors to obtain investment advice. Fourth, on the topic of insurance, given the diversity of advisers and highly specialized focus of certain advisory firms, it would be difficult for the SEC to dictate how much insurance an adviser should have. For example, would advisers be required to maintain a certain type of insurance (*e.g.*,

[39] 15 U.S.C. § 80b-6.

> cybersecurity)? How would the SEC assure that coverage levels are not unduly burdensome for smaller or newer advisers? Finally, states and other federal requirements already impose fidelity bonding requirements on certain advisers.[40]

Imposing regulations such as these three seems antithetical to the purpose behind Form CRS: to succinctly capture for retail clients the differences between broker-dealers and advisers. It seems contrary to then insist that adviser and broker-dealer regulation converge. Inherent in the SEC's decision to propose Form CRS is the recognition that the activities, business models, and client base of advisers and broker-dealers are not dissimilar. In this regard, extending broker-dealer-esque regulation to advisers seems contrary to the basis of the SEC's proposal and may serve to increase investor confusion.

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We appreciate the opportunity to comment on the IA Proposal. If the Commission or its Staff have any questions or wish to discuss the matters mentioned in this letter, please contact: Mark Perlow at [redacted] or [redacted]; Michael Sherman at [redacted] or [redacted]; David Vaughan at [redacted] or [redacted]; or Christine Ayako Schleppegrell at [redacted] or [redacted].

Very Truly Yours,

/s/ Dechert LLP

Dechert LLP

[40] 17 C.F.R. 270.17g-1 (2018).