



## SEC Bulletin on Conflicts of Interest for Broker-Dealers and Investment Advisers

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On August 3, 2022, the U.S. Securities and Exchange Commission (SEC) published a Staff Bulletin providing guidance regarding conflicts of interest under broker-dealer Regulation Best Interest (Reg BI) and investment adviser fiduciary duty standards.<sup>1</sup> The Bulletin, entitled “Standards of Conduct for Broker-Dealers and Investment Adviser Conflicts of Interest,” signals the Staff’s continued focus on conduct standards and expansive interpretation of these standards.<sup>2</sup> The Bulletin also reminds firms of their obligation—often beyond disclosure—to address conflicts and to have rigorous and dynamic policies in place to identify and address conflicts.

After an introductory background section summarizing conflict-of-interest rules under Reg BI<sup>3</sup> and investment advisers’ fiduciary duty,<sup>4</sup> the Bulletin takes the form of answers and guidance in response to 13 questions posed by a hypothetical firm. These questions and answers are grouped around concepts discussed in previous Reg BI guidance: identifying conflicts of interest, eliminating conflicts of interest, mitigating conflicts of interest, limited product menus, and disclosing conflicts of interest.<sup>5</sup> A few themes running through the Bulletin are discussed below.

### Broad Scope

Although formally the Bulletin cannot and does not articulate legal rules beyond the existing requirements of Reg BI and investment advisers’ fiduciary duty with respect to conflicts of interest, its interpretation of these requirements is broad, and the Staff appears to treat the two

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<sup>1</sup> SEC, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest*, <https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest> (Aug. 3, 2022).

<sup>2</sup> In March of this year, the SEC released a Bulletin on standards of conduct related to account recommendations for broker-dealers and investment advisers that similarly took a question-and-answer form and relied jointly on Reg BI and investment advisers’ fiduciary duty. SEC, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors*, <https://www.sec.gov/tm/iabd-staff-bulletin> (March 30, 2022).

<sup>3</sup> *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Exchange Act Release No. 86031, 84 FR 33318 (June 5, 2019).

<sup>4</sup> *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Investment Advisers Act Release No. 5248, 84 FR 33669 (June 5, 2019).

<sup>5</sup> See, for example, the SEC’s guidance to small broker-dealers at [https://www.sec.gov/info/smallbus/secg/regulation-best-interest#Conflict\\_of\\_Interest\\_Obligation](https://www.sec.gov/info/smallbus/secg/regulation-best-interest#Conflict_of_Interest_Obligation).

standards as identical. The Bulletin's first "answer" opens with a statement that "[a]ll broker-dealers, investment advisers, and financial professionals have at least some conflicts of interest with their retail investors"—a view the SEC itself has never explicitly expressed. Its last answer warns that a firm that has policies and procedures in place to identify and address conflicts cannot "stop worrying" but must continue to evaluate whether its policies remain adequate as it becomes aware of new information. In short, the Bulletin effectively mandates not only that broker-dealers and investment advisers have an initial conflicts identification process but also that they have an ongoing conflicts monitoring process. Throughout the Q&A, the Staff generally discusses the duties of broker-dealers and investment advisers with respect to conflicts as a coherent whole without considering whether Reg BI's requirements differ from an investment adviser's fiduciary duty. And it provides no guidance on how a firm can know that it has done enough to address any particular conflict. This framing shows a broad and aggressive approach to enforcing conflicts of interest for both broker-dealers and investment advisers.

## Elimination and Mitigation of Conflicts

The Bulletin contains sections on eliminating and mitigating conflicts before a final section on disclosure. This ordering is no accident. The Bulletin warns that identifying and disclosing conflicts is not in itself always sufficient for firms to meet their obligations (Question 5). It also repeatedly suggests that firms consider taking aggressive actions to address conflicts such as declining to provide advice in a certain area (Questions 5, 6, 9, and 10) or modifying incentive payment programs for employees (Questions 6 and 9). The Bulletin raises these actions as possibilities without precisely identifying under what circumstances they might be required. Firms should anticipate Staff questions regarding any particular conflict at issue in an exam or investigation as to why the actions that the firm took were sufficient and no more extensive mitigation actions were required.

## Compensation Arrangements

The first two examples of conflicts of interest identified in the Bulletin are internal and third-party compensation schemes that may create incentives for employees at odds with a client's interests (Question 2). These concepts recur throughout the Bulletin and appear to be the primary—although by no means the exclusive—sources of conflicts of interest in the Staff's view. The Staff is likely to take a broad view of what compensation schemes give rise to conflicts; the Bulletin notes that third-party compensation need not be "related to sales" to give rise to a conflict of interest and lists a wide variety of third-party payments that may need to be disclosed (Question 2; Question 12(b)).

## Limited Menus

The Bulletin devotes a single question (in its own section) to addressing conflicts arising from advice limited to a certain menu of products and also identifies this as a paradigmatic example of a situation that may give rise to a conflict of interest in its general overview of conflicts (Question 10; Question 2). In its discussion, the Staff suggests that firms "consider" establishing a process for reviewing limited menu product offerings that might result in declining to provide advice where the conflict presented by the limited product set cannot be otherwise mitigated (Question 10). This suggestion that limited menu product offerings are themselves evidence of a conflict is in

some tension with the Adopting Release for Reg BI, which expressly permits limited product sets.<sup>6</sup> The Bulletin expands Reg BI's requirement that broker-dealers disclose material limitations on product offerings.<sup>7</sup>

## Dynamic and Thorough Compliance Programs

Throughout the Bulletin, the Staff emphasizes the need to put in place written policies and processes to identify and address conflicts on a regular basis. It closes with an admonition that firms cannot “set it and forget it” and should “monitor conflicts over time and assess periodically the adequacy and effectiveness of their policies and procedures” (Question 13). The Staff further suggests documenting how a firm identifies and addresses conflicts of interest as a way of demonstrating its compliance with its obligations (Question 13).

Both broker-dealers and investment advisers should review this Q&A with care and prepare for the Staff to apply conflict-of-interest rules aggressively and broadly. The Bulletin offers no safe harbors, but firms will be best positioned to address Staff inquiries if they have thorough and thoughtful ongoing processes in place for identifying, monitoring, and addressing conflicts.

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<sup>6</sup> Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031, 84 FR 33318, 33393-94 (June 5, 2019).

<sup>7</sup> 17 CFR § 240.15l-1(a)(2)(iii)(C).