

APRIL 29, 2015

# Milne Legal Press Release

## *“Conflicts, Conflicts Everywhere”*

### I. Conflicts, Conflicts Everywhere

Registered investment advisers (“RIA”) are routinely faced with conflicts of interest. How the RIA addresses those conflicts, is of paramount importance to the U.S. Securities and Exchange Commission (“SEC”).

On February 26, 2015, Ms. Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement at the SEC, presented a very focused, clear and profound speech titled “Conflicts, Conflicts Everywhere” in Washington D.C.<sup>1</sup>

Ms. Riewe stated that conflicts of interest is one of the SEC’s “overarching concerns” with investment advisers and that in nearly every ongoing matter that the SEC is currently examining, there is the open issue of “whether the adviser in question has discharged its fiduciary obligation to identify its conflicts of interest and either: (1) eliminated the conflict, or (2) mitigated the conflict and disclosed their existence to boards or investors.” She went on to state that “over and over again we see advisers failing properly to identify and then address their conflicts.”

For RIAs, Ms. Riewe highlighted that conflicts of interests are particularly prevalent with principal transactions, best execution involving affiliated broker-dealers, and undisclosed compensation arrangements, i.e., undisclosed finders fees, solicitation fees and retrocession arrangements.

She concluded by stating: “On the horizon, we expect to recommend a number of conflicts cases for enforcement action”.

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<sup>1</sup> Ms. Riewe’s speech can be found in its entirety on the SEC’s website at:  
[http://www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html#.VQCN\\_ylDafR](http://www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html#.VQCN_ylDafR)

## II. Blackrock Advisors LLC Charged for Failing to Disclose Conflict of Interest to Clients

On April 20, 2015, the SEC charged Blackrock Advisors LLC with breaching its fiduciary duty by failing to disclose a conflict of interest created by the outside business activity of a top-performing portfolio manager.<sup>2</sup> An SEC director of the Division of Enforcement stated: “BlackRock violated its fiduciary obligation to eliminate the conflict of interest created by Rice’s outside business activity or otherwise disclose it to BlackRock’s fund boards and advisory clients.”<sup>3</sup>

The SEC Release announced that BlackRock was censured and agreed to settle the charges and pay a \$12 million penalty. The SEC also fined the then chief compliance officer for “failure to report a ‘material compliance matter.’” Additionally, the firm also must engage an independent compliance consultant to conduct an internal review.<sup>4</sup>

## III. Analysis

The SEC’ focus on conflicts of interest is nothing new.

In 1963, the U.S. Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.* held that Section 206 of the Advisers Act imposed a fiduciary duty on investment advisers. The Court stated that as a fiduciary “investment advisers could not completely perform their basic function -- furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments -- unless all conflicts of interest between the investment counsel and the client were removed.”<sup>5</sup>

The Court concluded that investment advisers must take affirmative action “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.”<sup>6</sup>

Although it has been over 50 years since the Supreme Court in *Capital Gains* confirmed that all RIA are fiduciaries, the fiduciary duty to disclose all conflicts of

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<sup>2</sup> See SEC Release 2015-71 at: <http://www.sec.gov/news/pressrelease/2015-71.html>

<sup>3</sup> Id.

<sup>4</sup> Id.

<sup>5</sup> *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

<sup>6</sup> Id. at 191-92 (emphasis added).

interest has arguably never received as much attention from the SEC as it has today.

### III. Conclusion

Indeed, the recent Blackrock settlement for USD 12 million and Ms. Riewe's conclusion that "[o]n the horizon, we expect to recommend a number of conflicts cases for enforcement action", should put all RIAs on notice of the importance of disclosing and/or eliminating an investment adviser's conflicts of interest with its clients.



**Dustin W. Milne**  
*Managing Partner*

*"We recommend that every chief compliance officer carefully read Ms. Riewe's speech and begin to draft policies and procedures for implementing the SEC's recommendations on how best to eliminate (or at a minimum to mitigate and to disclose) the RIA's conflicts of interest.*

*The RIA firm should 'take a step back, and rigorously and objectively evaluate its personnel, its business, its various fee structures, and its affiliates.'*



**Charles Lerner**

*Milne Legal believes the best way to do this is for the RIA to form an objective and empowered conflicts committee which meets routinely to evaluate all aspects of the RIA's business, including all sources of the RIA's revenue streams and business relationships, and puts in place step-plans for eliminating, or mitigating and disclosing, each and every conflict that the committee has identified."*

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