



## **Flashpoint: Regulation Best Interest and More... A Present to Investors from the SEC**

**By S. Derrin Watson, Of Counsel**

The Securities and Exchange Commission (SEC) has published a package of rules and interpretations ("SEC Rule") dealing with the duties broker-dealers and investment advisors owe to their customers, including individual plan participants. The SEC originally proposed the package in April 2018, weeks after the 5<sup>th</sup> Circuit Court of Appeals vacated the fiduciary (a.k.a., conflict of interest) regulations initiated by the U.S. Department of Labor (DOL). The final SEC package, while addressing similar themes, takes a distinctly different approach than did the DOL.

This is the first in a series of Ferenczy FlashPoints we will be publishing regarding these new rules, which become effective on June 30, 2020.

Of course, the SEC Rule applies to those investment professionals regulated by the SEC. It covers a wider range of actions (including investment recommendations that have nothing to do with retirement plans), but a narrower class of regulated persons than the DOL rules. Specifically, the SEC Rule applies to:

- Brokers, dealers, and individuals associated with them ("BDs"), and
- Investment advisors under the Advisor's Act ("IAs").

And, while this guidance is much more broad-based, the SEC Rule does discuss retirement plan issues, most particularly rollovers and account selection. We will, of course, focus in our FlashPoints on the rules as they relate to retirement plans.

The new SEC Rule has no impact on TPAs operating as such. However, the DOL has announced that it is planning to issue a new proposed fiduciary rule, perhaps in December. It is anticipated that the new DOL guidance will coordinate with the SEC Rule

## Broker-Dealers and Investment Advisors ... And the Differences Between Them

The SEC deliberately chose not to provide a “one size fits all” approach for both BDs and IAs, fearing that would “risk reducing investor choice and access to existing products, services, service providers, and payment options, and would increase costs for firms and for retail investors in both broker-dealer and investment adviser relationships.”

The SEC observes that the DOL’s vacated fiduciary regulation resulted in “a significant reduction in retail investor access to brokerage services, and . . . the available alternative services were higher priced in many circumstances.” The SEC wanted to avoid that result by continuing a marketplace in which both BDs and IAs, operating with retail customers under very different relationships and compensation models, could continue to function.

As with the DOL’s vacated fiduciary regulation, the SEC proposed Rule generated thousands of comments. Most commentators requested 18 months to 2 years to phase in the new requirements. The SEC gave BDs only 12 months to adjust to the new rules. While the new IA interpretation is effective immediately, the SEC observes that it “does not itself create any new legal obligations” and is “generally consistent with investment advisers’ current understanding of their fiduciary duty.”

### The Structure of the Guidance

There are four distinct pieces to the SEC Rule:

- Regulation Best Interest (“Reg BI”) includes new rules with which BDs must comply by June 30, 2020.
- Form CRS Relationship Summary and Form ADV Amendments, (“CRS”) which both broker-dealers and investment advisers must provide to retail investors, beginning June 30, 2020.
- A Commission Interpretation Regarding Standard of Conduct for Investment Advisers (“SoC”), going into effect immediately, outlining principles governing IAs.
- A Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, going into effect immediately, clarifying the ability of BDs to provide advice without becoming subject to the Advisers Act and its fiduciary duties.

Reg BI weighs in at a whopping 771 pages, with nearly 1,700 footnotes! Of those 771 pages, the regulatory text itself begins on page 765. However, there are hundreds of pages of analysis and commentary, in addition to a detailed discussion of economic consequences.

### Who Are We Protecting?

The SEC Rule specifically discusses the obligations BDs owe to their clients. Reg BI and CRS seek to protect the “retail customer,” an individual receiving a recommendation or advice and who will use it “primarily for personal, family, or household purposes.” Thus, this guidance impacts recommendations given to plan participants and IRA owners, but does not affect advice given to employers or to plan fiduciaries in their capacities as such. Enhanced protection for plan participants will have to wait for the DOL. However, as noted above, both Reg BI and SoC protect recommendations and advice relating to rollovers and to account selection in retirement plans.

## Broker-Dealer Obligations to Customers

Reg BI requires that, when BDs make recommendations to retail customers, they must “act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.” The differences between the SEC Rule and the now vacated DOL rules are starkly apparent. The DOL, by making people ERISA fiduciaries, required that they act in the exclusive interest of plan participants and beneficiaries. The SEC requires that BDs not put their interests ahead of their customers, but acknowledges the reality that purely disinterested advice is impractical in the broker-dealer model.

To accomplish this goal, Reg BI requires BDs to comply with four specific obligations:

1. *Disclosure Obligation.* Before or at the time of the recommendation, the BD must provide a **written disclosure** to the retail customer of all material facts related to conflicts of interest, and all material facts related to the scope and terms of the relationship with the customer. This includes a statement that the BD is acting as such, the fees and costs that apply to the customer, and the type and scope of services provided, including limitations on recommendations.
2. *Care Obligation.* The BD must **exercise reasonable care, diligence, and skill** to:
  1. Understand the risks, rewards, and costs of the recommendation and reasonably conclude the recommendation would be in the best interest of some customers,
  2. Reasonably conclude the recommendation is in the best interest of the particular retail customer, based on the customer’s investment profile, and does not place the BD’s interests ahead of the customer’s, and
  3. Reasonably conclude that a series of transactions is not excessive.
3. *Conflict of Interest Obligation.* The BD is to eliminate, or at least disclose, **conflicts of interest**. Specifically, the BD must eliminate all sales contests or quotas, bonuses, and non-cash compensation rewarding sales of specific securities or types of securities within a limited time frame.
4. *Compliance Obligation.* The BD must establish, maintain, and enforce **policies and procedures** reasonably designed to facilitate compliance.

It is important to note that the Reg BI recognizes that advice from a BD to a customer is transaction-related, rather than relationship-related. Therefore, unless a BD specifically takes on this responsibility, there is no obligation for him or her to monitor the investments of a client or to provide ongoing advice. Furthermore, the standard applies specifically at the time of the transaction, and determinations of the appropriateness of the transaction are not to be made based on hindsight.

## What About Investment Advisers?

While not setting forth detailed rules for IAs, who have long been subject to a fiduciary standard under the SEC rules, the SoC reemphasized that advisors are subject to a significant duty of care and loyalty. More about this next time ...

## Conclusion

There is a saying about “waiting for the other shoe to drop.” The thud you heard June 5 was the SEC dropping a long-awaited shoe, but there are still more shoes to follow. The SEC promises compliance assistance. There will almost undoubtedly be lawsuits challenging the new rule. And

the DOL is at work on its own guidance. Ultimately, this is only the beginning. However, particularly for BDs, the short compliance time frame means there is no time to waste in digesting and adapting to the new rules.



**FERENCZY**  
BENEFITS LAW CENTER

ERISA  
*We are your ^ solution™*

Ilene Ferenczy • [ilene@ferenczylaw.com](mailto:ilene@ferenczylaw.com) | Alison Cohen • [acohen@ferenczylaw.com](mailto:acohen@ferenczylaw.com)  
Adrienne Moore • [amoore@ferenczylaw.com](mailto:amoore@ferenczylaw.com) | Adriana Starr • [astarr@ferenczylaw.com](mailto:astarr@ferenczylaw.com)  
Tia Thornton • [tthornton@ferenczylaw.com](mailto:tthornton@ferenczylaw.com) | Leah Dean • [ldean@ferenczylaw.com](mailto:ldean@ferenczylaw.com)

---

2635 Century Parkway Suite 200, Atlanta, GA 30345  
T 404.320.1100 | F 404.320.1105 | [www.ferenczylaw.com](http://www.ferenczylaw.com)