THE
NATIONAL LAW REVIEW

Best Interest and Best Practices: Improving Retirement Outcomes #2

DrinkerBiddle
Article By
Fred Reish
Drinker Biddle & Reath LLP
FredReish.com

- Financial Institutions & Banking
- Labor & Employment

- All Federal

Wednesday, September 19, 2018

This is the second of a new series of articles entitled "The Bests." This series focuses on Best Interest and Best Practices. Those topics will give me flexibility to talk about a range of subjects that affect both service providers, including advisors, and plan sponsors, including 401(k) committees.

In my last **post**, I discuss the remarkable similarities among the SEC's proposed Regulation Best Interest, the SEC's proposed Interpretation for investment advisors, the DOL's Best Interest standard of care (which is a combination of ERISA's prudent man rule and duty of loyalty), and the New York State Best Interest standard for sales of annuities and insurance products. All of those rules require that advisors act with care, skill, prudence and diligence, and that they place the interests of the investor ahead of their own.

In the first post, I conclude that the Best Interest standard requires the following:

- A careful and skillful professional process measured by the objective standard of a knowledgeable and experienced advisor; and

- A duty of loyalty to the investor.

This post discusses the type of process that would satisfy the Best Interest standard for all of those rules. However, since the process is not well defined (other than in guidance under ERISA), some of the suggestions in the post may, in fact, be Best Practices. Let me define that term. "Best Practices" means that the advisor is doing more than is required by the law. While Best Interest may be required, Best

Practices is not; it is voluntary. As a result, Best Practices are for advisors who desire to excel, while Best Interest is for advisors who want to be compliant.

In my view, a combination of Best Interests and Best Practices suggests that advisors should use the following process:

- Gather the information that is relevant to providing Best Interest advice. ("Relevant" means the information that is necessary to develop a recommendation that is appropriate for the investor. A synonym in this circumstance would be "material" information. If information about the needs and circumstances of the investor could affect the recommendation, then it is material and relevant).

- Consider the types of investments (and insurance products) and strategies that are appropriate for the investor based on the analysis of the investor's profile (that is, based on analysis of the relevant information). In effect, this step is the formulation of a strategy for the investor based on the products and services available to the advisor. While there may be some flexibility if the advisor only has access to limited types of products, that flexibility is limited, in the sense that any recommendation will still be measured by the Best Interest standard of care.

- Select the particular investments, insurance products and services that will be recommended to the investor, that is, that will populate and implement the investment strategy. As the SEC said in its proposed guidance, while cost and compensation are not the only factors to be considered, their significance is enhanced under the SEC proposals. In other words, they are major considerations. Another obvious important consideration is the quality of the product. That includes the "management" of the product, for example, the investment advisor for a mutual fund, the investment manager for an investment service, and the insurance company issuing an annuity contract or life insurance policy.

I suspect that, if an advisor gets into trouble because of his or her recommendations, it will be the result of an inappropriate (and perhaps unsuitable) strategy, excessive costs and compensation, or inferior quality of the "manager" of the product.

That begs the question of, how does an advisor demonstrate a Best Interest process? Other than for the DOL and ERISA plans, there is not a requirement to maintain documentation of the process. However, it probably goes without saying that a well-documented process is good risk management (and, for that matter, that a well-documented process is likely to be a prudent process).

In the next year or two, the SEC may enhance its guidance to further define the processes that are needed to satisfy its Best Interest standard. More certainly, though, the SEC, FINRA, DOL and New York State regulators will, in due course—perhaps over the next three years or so—begin their enforcement activities. Unfortunately, it's possible that we may see "regulation by enforcement," meaning that the holes in the guidance are filled in by the enforcers, rather than the regulators.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

Part 1 - Best Interest and Best Practices: Improving Retirement Outcomes #1

Part 3- Best Interest and Best Practices #3: Best Practices for Plan Sponsors: Projection of Retirement Income

Part 4- Best Interest and Best Practices #4: What is the Baseline for A Committee to Act in the Best Interest of Its Participants? (Part 1)

Part 5 - Best Interest and Best Practices #5: What is the Baseline for A Committee to Act in the Best Interest of Its Participants? (Part 2)

Part 6 - Best Interest and Best Practices #6: What is the Baseline for A Committee to Act in the Best Interest of its Participants? (Part 3)

Part 7 - Best Interest and Best Practices #7: SEC Best Interests . . . When? And What About the DOL

Part 8 - Best Interest and Best Practices #8: Fiduciary Training - The Need for Basics

Part 9 - Best Interest and Best Practices #9: Improving Retirement Outcomes