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# Best Interest Standard of Care for Advisors #13

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## Regulation Best Interest:

*The SEC has issued its final Regulation Best Interest (Reg BI), Form CRS Regulation, RIA Interpretation and Solely Incidental Interpretation. I am discussing the SEC's guidance in a series of articles entitled "Best Interest Standard of Care for Advisors."*

*The SEC's Reg BI establishes a best interest standard of care for investment recommendations to retail customers by broker-dealers and their registered representatives. In addition, Reg BI requires new disclosures and mitigation of advisor's financial conflicts of interest. The SEC also issued an Interpretation of the Standard of Conduct for Investment Advisers, which clarified the SEC's position on a number of issues related to the fiduciary standard and conflicts of interest for RIAs. There were two other pieces of guidance: the Form CRS Regulation (which requires a simplified front-end disclosure by broker-dealers and investment advisers); and the Solely Incidental Interpretation for limited discretion and monitoring of accounts by broker-dealers.*

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In the adopting release for the final Regulation Best Interest, the SEC explained some of the most significant changes from the proposal. Here are three of those changes with my comments:

- ***Implicit Hold Recommendations:***

*While broker-dealers will not be required to monitor accounts, in instances where a broker-dealer agrees to provide the retail customer with specified account monitoring services, it is our view that such an agreement will result in buy, sell or hold recommendations subject to Regulation Best Interest, even when the recommendation to hold is implicit.*

**Comment**: Reg BI permits broker-dealers to agree to periodically (but not continuously) monitor customer's accounts for the purpose of making buy, sell or hold recommendations. For example, a broker-dealer might agree to monitor a customer's account on a quarterly basis. But, if a broker-dealer does agree to monitor, then it must, of course, actually monitor. If the agreement is for quarterly monitoring, and the broker-dealer (or the advisor) does not communicate with the customer on that basis, it is deemed to be a recommendation to hold (even though it is implicit). (But, if the broker-dealer does not agree to monitor, silence will not be considered to be a recommendation to hold.) Obviously, the agreement to monitor creates supervision issues.

With all of that in mind, why would broker-dealers agree to monitor? One reason is that the new Form CRS (beginning June 30, 2020) requires broker-dealers to state, on a clearly written two-page form, whether or not they agree to monitor. Here's what the CRS instructions say:

*"Monitoring: Explain **whether or not** you monitor retail investors' investments, including the frequency and any material limitations. If so, indicate whether or not the services described in response to this Item 2.B.(i) are offered as part of your standard services."* (Emphasis added.)

To answer the question, the reason is that some broker-dealers, and their advisors, may be reluctant to tell their customers that they are not agreeing to monitor their accounts...particularly if they have previously given those customers the impression that they are monitoring the accounts.

- ***Recommendations of account types, including recommendations to roll over or transfer assets from one type of account to another:***

*We are modifying Regulation Best Interest to expressly apply to account recommendations including, among others, recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA, recommendations to open a particular securities account (such as brokerage or advisory), and recommendations to take a plan distribution for the purpose of opening a securities account. We are also providing guidance under the Care Obligation on what factors a broker-dealer generally should consider when making such recommendations.*

**Comment**: Both Reg BI and the RIA Interpretation say that broker-dealers and investment advisors are required to act in the "best interest" of their investors when making recommendations of "account types." While that was not required under the suitability standard, it will be mandated when the Reg BI requirements must be satisfied, beginning June 30, 2020. In other words,

broker-dealers and their advisors must initially consider all of the account types reasonably available for a retail customer and must, based on the customer's investment profile, recommend the account type that is in the best interest of the investor.

A clear example is the recommendation of a rollover. In that case, an advisor (and the broker-dealer) must consider leaving the money in the plan, rolling to an IRA, and other alternatives available to the participant. And the advisor must, after considering the relevant factors with "care, skill and diligence," make a recommendation that is in the best interest of the participant. I expect that, in due course, the SEC or FINRA will conduct examinations on that issue.

Reg BI lists factors to be considered in making a rollover recommendation. That will be the subject of a future post.

- ***Dual-Registrants:***

  *We are providing additional guidance on how dual-registrants can comply with Regulation Best Interest, and confirming that Regulation Best Interest does not apply to advice provided by a broker-dealer that is dually registered as an investment adviser (''dual-registrant'') when acting in the capacity of an investment adviser, and that a dual-registrant is an investment adviser solely with respect to accounts for which a dual-registrant provides advice and receives compensation that subjects it to the Advisers Act.*

  **Comment**: While the SEC's explanation describes which duties apply to dual registrants in those circumstances, some of the more interesting issues are for "dual-hatted" advisors (that is, advisors who are representatives of both a broker-dealer and an RIA). For example, those dual hatted advisors must deliver the new Form CRS for both entities when they are talking to potentially new retail investors. It doesn't matter if the advisor intends to wear one of the hats or the other, both Forms CRS must be delivered. Obviously, that will require some explanation to the potential investors and may create confusion. A more substantively issue, though, is a requirement that a dual hatted advisor consider all reasonably available accounts of the broker-dealer and the RIA before making a recommendation of the account type. That is a new requirement and it will require some thought to design compliance procedures.

## Conclusion

Reg BI includes significant changes for broker-dealers. As a result, broker-dealers should start by learning the new requirements. The next step is to design compliant processes. Then the hard work on policies and procedures, supervision and training can begin. Time is short. The new rules require compliance on June 30, 2020.