

THE
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Three Parts of "Best Interest Standard of Care": Interesting Angles on the DOL's Fiduciary Rule #20

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As I discussed in an earlier post, the Best Interest Standard of Care has three parts: The prudent man rule; a requirement for individualization; and a duty of loyalty. Notice that none of the three parts requires that the "best" investment be recommended

Because of concerns that the fiduciary rule might be interpreted to require that a "best" investment requirement would apply, the Department of Labor explained in the preamble to the fiduciary regulation that:

In response to commenter concerns, the Department also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single "best" investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible.

So, if you ever had any doubts, it should be clear now that the "Best" Interest Standard of Care is just a label (but a label which, at some level, resonates politically).

If the requirement isn't that the best investment be recommended, what is it? The answer is that it's the same standard that advisers have used for about 40 years in recommending investments to ERISA-governed, tax-qualified retirement plans. In other words, it's been around for a long time and many advisers have survived and thrived under that standard. As the DOL explained in the guidance:

The Best Interest standard . . . is intended to effectively incorporate the objective standards of care and undivided loyalty that have been applied under ERISA for more than 40 years.

But, the duty of prudence should not be confused with the suitability standard. While unsuitable recommendations will not be prudent, it does not necessarily mean that suitable recommendations will be prudent. As the DOL explained:

The Department has not specifically incorporated the suitability obligation as an element of the Best Interest standard, as suggested by FINRA but many aspects of suitability are also elements of the Best Interest standard. An investment recommendation that is not suitable under the securities laws would not meet the Best Interest standard.

As a result, advisers who have not worked with retirement plans under ERISA's prudent man rule should consider education about the processes required for compliance with the fiduciary standard.

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

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