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How Does an Adviser Know How to Satisfy the Best Interest Standard?: Interesting Angles on the DOL's Fiduciary Rule #46

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This is 46th article about interesting observations concerning the Department of Labor's fiduciary rule and exemptions. These articles also cover the DOL's FAQs interpreting the regulation and exemptions and related developments in the securities laws.

Beginning on June 9, the new "transition" exemptions will apply to investment and insurance (*e.g.*, annuities) recommendations for IRAs. If an adviser and his supervisory entity (the "financial institution") are "pure" level fee fiduciaries, there will not be a prohibited transaction under the Internal Revenue Code (so long as the fees are reasonable). Two consequences flow from that. First, the adviser and entity will not need to use the Best Interest Contract Exemption (BICE), which means that they will not be bound by the best interest standard of care. Second, their services to the IRA will be regulated by the securities laws, and not by these new rules.

But, if there is a financial conflict of interest (that is, a prohibited transaction, or PT), the adviser and entity (*e.g.*, broker dealer) will need to use an exemption in order to be paid. The most likely exemption is BICE, and one of the conditions is that the adviser and entity adhere to the "best interest standard of care." But, what is the best interest standard of care? In essence, it is a combination of ERISA's prudent man rule and duty of loyalty. Literally, it is:

> *Investment advice is in the "Best Interest" of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.*

While advisers to retirement plans are familiar with those concepts, many advisers to IRAs are not. That raises the question, how can those advisers know what is required? The answer is that fiduciary training and education are needed . . . and needed immediately in light of the June 9 applicability date.

What is the basis for the training? Answer: The fiduciary requirements in ERISA. The DOL made that clear in the preamble to BICE:

> *"The Best Interest standard set forth in the final exemption is based on longstanding concepts derived from ERISA and the law of trusts. It is meant to express the concept, set forth in ERISA section 404, that a fiduciary is required to act "solely in the interest of the participants . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Similarly, both ERISA section 404(a)(1)(A) and the trust-law duty of loyalty require fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest."*

As a result, broker-dealers and others should look to training and education materials based on ERISA's provisions, DOL regulations and guidance, and ERISA litigation. Those materials should cover the broad concepts and principles, but should also provide detailed education about the information to be reviewed and the processes to be followed, on a step-by-step basis.

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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