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SEC Proposed Reg BI and Recommendations of Rollovers (Part 1): Interesting Angles on the DOL's Fiduciary Rule #92

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This is my 92nd article about interesting observations concerning the Department of Labor's (DOL) fiduciary rule and exemptions and the SEC's "best interest" proposals.

On April 18, 2018, the SEC released three proposals for comment—Regulation Best Interest ("Reg BI") for broker-dealers, an Interpretation about the Standard of Conduct for RIAs ("RIA Interpretation"), and a CRS—Customer/Client Relationship Summary for both broker-dealers and RIAs. That was the beginning of a lengthy process, and the outcome is uncertain. However, if these rules are finalized, the impact on the securities industry and investors will be significant.

My first reaction is that Reg BI, which imposes a best interest standard of care on broker-dealers, is strikingly similar to the DOL's Best Interest Contract Exemption (BICE). There are major differences—for example, the SEC proposal does not create a private right of action for investors, and some of the disclosure requirements are eliminated. However, once you get beyond the differences, the similarities are striking.

Let's discuss the SEC's Best Interest standard for broker-dealers in the context of recommendations of plan distributions and rollovers.

First, the SEC acknowledges that a rollover recommendation involves an inherent conflict of interest. In footnote 204 the SEC states: "*For example, firms and their registered representatives that recommend an investor roll over plan assets to an IRA may earn commissions or other fees as a result, while a recommendation that a retail investor leave his plan assets with his old employer or roll the assets to a plan sponsored by a new employer likely results in little or no compensation for a firm or a registered representative.*"

On pages 82 and 83 of the Reg BI package, the SEC explains that "*Securities transactions may also include recommendations to rollover or transfer assets from one type of account to another, such as recommendations to roll over or transfer assets in an ERISA account to an IRA.*"

The significance of rollovers being classified as "securities transactions" is that the proposed best interest standard of care applies to recommendations of securities transactions. That is, a recommendation to a participant to take a distribution from his or her 401(k) plan and roll over to an IRA is, in effect, a recommendation that the participant sell the mutual funds in his or her account and rollover the cash proceeds.

In fact, the rollover process involves two securities transactions. In footnote 155, the SEC explains: "*A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to FINRA suitability obligations. For example, a firm may recommend that an investor sell his plan assets and roll over their cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase securities for a newly-opened IRA are subject to FINRA's suitability obligations. See FINRA Regulatory Notice 13-45.*"

In addition to the existing suitability obligation, Reg BI would impose a best interest standard of care, including a duty of loyalty, such that the recommendation to sell the investments in the plan (for example, a 401(k) plan)

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would be subject to both suitability and best interest. The suitability and best interest standards would also apply to recommendations about the re-investment of distributed money in an IRA.

That raises a question about how a best interest recommendation of a distribution and rollover should be made. What steps should be followed? That will be the subject of my next article.

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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