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## Regulation Best Interest Recommendations by Broker-Dealers: Part 1- Interesting Angles on the DOL's Fiduciary Rule #95

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This is my 95th article about interesting observations concerning the Department of Labor's (DOL) fiduciary rule and exemptions and the SEC's "best interest" proposals.

By now, you probably know that both the SEC's proposed Regulation Best Interest ("Reg BI") for broker-dealers and the Interpretation Regarding Standard of Conduct for Investment Advisers ("RIA Interpretation") have a best interest standard of care. The Reg BI best interest standard is for broker-dealers, while the RIA Interpretation best interest standard is for investment advisers.

At first blush, that suggests that broker-dealers and RIAs will be governed in the same way. That's not the case.

While the RIA best interest standard applies to all advice to all clients, Reg BI only applies to securities recommendations made by broker-dealers to retail customers. Those are significant differences.

Let's take a look at that.

Using the SEC's language, the Reg BI standard applies to a broker-dealer "when making a recommendation of any securities transaction or investment strategy involving securities." It doesn't apply to recommendations about which account type to use, unless the recommendation involves securities transactions. On the other hand, RIAs are governed by the best interest standard of care when recommending account types.

There are similarities in how the standard applies to recommendations of distributions from retirement plans or to the recommendation of transfers of IRAs. (As this suggests, plan participants and IRA owners are "retail customers" covered by Reg BI.) Once again, though, a recommendation of a transfer of an IRA or a distribution from a plan would only be covered by Reg BI if the recommendation involved a "securities transaction or investment strategy involving securities."

If the recommendation to take a distribution is made to a participant in a 401(k) plan, that implicitly includes a recommendation to liquidate the investments in the participant's account in order to take a cash distribution. (See FINRA Regulatory Notice 13-45.) The recommendation to liquidate the investments in the participant's account would be covered by the best interest standard of care. The recommendation about how to invest the rollover IRA in securities is a second recommendation that would also be subject to Reg BI and the best interest standard.

However, it does not appear that the best interest standard would apply to recommendations to plans that are not participant directed. For example, a recommendation to take a distribution from a defined benefit pension plan or a cash balance pension plan does not seem to be a securities recommendation, because the participant does not have the ability to liquidate plan investments.

On the other hand, a recommendation by an RIA to take a distribution from any type of plan would be covered by the best interest standard. Similarly, for RIAs a recommendation about the investments in the rollover IRA would also be covered by the best interest standard.

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With regard to transfers of IRAs, the same “securities transaction” limitation applies to recommendations by broker-dealers. So, where a representative of a broker-dealer recommends that an IRA be transferred to the broker-dealer, but there is not a recommendation to buy, sell or hold securities (and, instead, the IRA is transferred without the liquidation of securities), there would not be a recommended securities transaction. As a result, the best interest standard of care would not apply. However, if the broker-dealer’s representative recommended that the investments be sold and then the cash transferred to an IRA with the broker-dealer, that would be subject to the best interest standard.

Any recommendation by an RIA to transfer an IRA or to sell the investments in the IRA would be subject to the best interest standard.

This article illustrates two points. The first is that the best interest standard of care for broker-dealers is much more limited than the one for RIAs. The second is that the SEC’s proposals are not clear on several major points. For example, wherever I use the words “appear” and “seem” in this article, it means that the SEC’s proposed Reg BI did not discuss the application of the proposed standard in enough detail to be certain about how it applies.

ADDITIONAL THOUGHTS: Reg BI is a proposal by the SEC to impose a higher standard of care on broker-dealers. It will not apply until it is finalized—perhaps a year and a half or two years from now. On the other hand, the RIA Interpretation is, for the most part, an interpretation of the current rules. As a result, RIAs should pay close attention to the RIA Interpretation.

*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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