Benefits Brief

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New Regulation Best Interest FAQs Address Topics Familiar to DOL Fiduciary Rule Veterans

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On January 10, 2020, the staff of the Securities and Exchange Commission ("SEC") updated its frequently asked questions on Regulation Best Interest (the "FAQs").

While much of the information within the FAQs is not new and was taken from the SEC's Adopting Release, the FAQs are significant for three reasons:

- The FAQs provide an example of a type of sub-regulatory guidance that the Federal Agencies may issue notwithstanding President Trump's October 9, 2019 guidance "Promoting the Rule of Law Through Improved Agency Guidance Documents" (the "Executive Order").
- The FAQs provide helpful insight into how programs developed in response to the now vacated 2016 Department of Labor ("DOL") Fiduciary Rule (the "2016 Rule") may assist broker-dealers with their Regulation Best Interest compliance efforts.
- The FAQs are a new data point for developing theories around what DOL may do in any new fiduciary rule proposal.

Sub-Regulatory Guidance

Last October, President Trump issued an Executive Order that prohibits federal agencies from imposing "legally binding requirements on the public" without going through notice and comment. However, the Executive Order permitted the federal agencies to "clarify existing obligations through non binding guidance" so long as there is no "implicit threat of enforcement if the regulated public does not comply." One concern regarding the Executive Order was whether federal agencies would be unable, or unwilling, to publish meaningful guidance helpful to regulated communities.

In the FAQs, the SEC shows that federal agencies may still issue sub-regulatory guidance but the SEC is careful to clarify that the FAQs do not carry the force of law by explaining that the FAQs "are not a

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rule, regulation, or statement of [the Commission]… These responses, like all staff guidance have no legal force or effect: they do not altar or amend applicable law, and they create no new or additional obligations for any person."

Using Lessons from the DOL's 2016 Rule for Regulation Best Interest Compliance

Like the FAQs DOL issued after releasing the 2016 Rule, the SEC FAQs respond to industry questions about four key topics – Recommendation, Disclosure Obligation, Care Obligation, and Conflict of Interest Obligation. In many cases, the SEC answers the same questions that the DOL answered in 2016. While the SEC responses on how broker-dealers can comply with Regulation Best Interest are generally more favorable than the DOL's 2016 responses to the same questions, the FAQs indicate that Regulation Best Interest may raise the standard of care and compliance obligations for financial institutions more than some consumer groups had expected.

Recommendations

Account recommendations are considered recommendations. These include account opening and recommendations to transfer (or roll over) assets between types of accounts. Account type recommendations go beyond brokerage or advisory and cover recommendations about types of accounts (e.g., IRA, Roth IRA, versus SEP-IRA accounts). A broker representative need not recommend an advisory account if he or she is not dually licensed, but can only recommend the brokerage account if it is in the client's best interest. For hybrid advisors and others who can recommend more than one type of account, professionals are required to consider whatever account-types they are permitted to offer. The impact of a particular representative's licensure on the ability to make account recommendations was a frequently asked question under the 2016 Rule.

Whether a communication rises to a "recommendation" is determined under the traditional securities law framework. In this analysis, whether the communication could reasonably be viewed as a "call to action" is an important consideration, with more individually tailored communications being more likely to be viewed as recommendations. In these FAQs, the scope of what constitutes a recommendation is very similar to where the 2016 Rule came out, striking a balance between broad coverage and wanting to encourage savings and investment education. And while "Hire me" recommendations are covered by Regulation Best Interest, the FAQs expressly exclude activities such as giving out a business card and asking for a follow-up call. Similarly, a broker representative telling a customer that he or she is changing firms does not by itself constitute a recommendation, although attempts to persuade the client to follow may be a recommendation. Describing the legal contribution limits for IRAs, required minimum distribution rules for retirement accounts, or describing a company's retirement plan options would not by themselves be "recommendations" and would instead be "investment education or descriptive information".

Disclosure Obligation

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The FAQs clarify that the SEC does not expect that broker-dealers will be able to comply with Regulation Best Interest's Disclosure Obligation by issuing the Form CRS alone. Similarly, the FAQs clarify that disclosures that are required under Regulation Best Interest (including the Form CRS) must comply with the SEC's existing framework of e-delivery. The SEC also advised that while broker-dealers may send disclosure documents that are intended to satisfy their Disclosure Obligations within quarterly mailings after June 30, 2020, such disclosures will not satisfy a broker-dealer's Disclosure Obligation for any recommendations that occur between June 30 and the date that the broker-dealer provides the disclosures.

Conflict Obligation

Like the DOL's 2016 Rule, the SEC's Regulation Best Interest prohibits certain broker-dealer conflicts such as sales contests and sales quotas that are based on the sales of specific or types of securities within a limited time frame. The FAQs describe that firms could, but are not required to manage conflicts of interest through level fee compensation models or basing differential compensation on neutral factors (similar to the DOL's 2016 Rule) in order to promote compliance with the Conflict Obligation. However, the FAQs re-emphasize that Regulation Best Interest does not mandate a one size fits all approach to mitigating conflicts, and that a firm can mitigate conflicts through a variety of methods that do not include neutral factors or level fees. The SEC provided a list of practices that a broker-dealer may implement to comply with the Conflict Obligation that include many of the same practices described by the DOL within its 2016 Rule such as:

- "avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- Eliminating incentives within comparable product lines; and
- Implementing supervisory procedures to monitor recommendations near certain thresholds, involving proprietary products, and recommendations involving rollovers."

Revised Fiduciary Rule Proposal

DOL officials have repeatedly stated that their next fiduciary proposal will "harmonize" with the SEC's rules. In some ways, the FAQs further clarify the overlap between Regulation Best Interest and the 2016 Rule. For example, the scope of the definition of "recommendation" in each is meant to exclude actions that might stifle investment education or retirement savings. However, the FAQs also point out areas where disharmony could be perceived and accommodations may be necessary from the DOL, such as in the area of representative compensation structures. That being said, we are hopeful that the period of trying to read tea leaves will soon end. DOL was tasked with reviewing its 2016 Rule almost three years ago through a Presidential Memorandum on February 3, 2017 and we are optimistic that the DOL's response will be released soon.

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