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Regulation Best Interest Obligates Broker-Dealers, Excuses RIAs

On May 9, 2018, the SEC released its much-anticipated proposed rule ("*Regulation Best Interest*"), which is intended to set the standard of conduct for broker-dealers and displace the DOL Fiduciary Rule.[1]

As anticipated, the SEC is not proposing to hold broker-dealers and their associated persons to a fiduciary standard. Instead, Regulation Best Interest would require the broker-dealer "to act in the best interest of the retail customer at the time the recommendation is made without placing the financial interest of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interest of the retail customer."[2] The standard of conduct will be satisfied if the broker-dealer complies with the following obligations:[3] Disclosure Obligation. A broker-dealer or its associated person must, before or at the time of the recommendation, reasonably disclose in writing the material facts relating to the scope and term of the relationship with the retail customer and all material conflicts of interest associated with that recommendation.[4] Examples of "material facts" include, but are not limited to, that the broker-dealer is acting in the capacity of a broker-dealer with respect to the recommendation; fees and charges that apply to the customer's transactions, holdings, and accounts; and the type and scope of services provided by the broker-dealer.[5] Care Obligation. A broker-dealer, when making a recommendation, must exercise reasonable diligence, care, skill, and prudence to:

- understand the potential risks and rewards associated with the recommendation, and have a reasonable basis to believe it could be in the best interest of at least some retail customers;
- have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on their investment profile and the potential risks and rewards associated with the recommendation; and
- have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of their investment profile.[6]

Conflict of Interest Obligations. A broker-dealer entity must establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose, or eliminate:

- all material conflicts of interest that are associated with recommendations covered by Regulation Best Interest;[7] and
- all material conflicts of interest arising from financial incentives associated with the recommendations.[8]

Note that the proposed Regulation Best Interest generally does not apply to investment advisers or dual registrants. It applies to those entities "only when [they are] making a recommendation in their capacity as a

broker-dealer."[9] This is true "even if the dual registrant executes the [recommended] transaction." [10] Accordingly, if the rule is adopted in its current form, we believe it will have little impact on RIAs that are dual registrants and no impact on those that are not. If you have any questions related to the proposed Regulation Best Interest, please feel free to contact us. ***John I. Sanders*** is an associate based in the firm's Winston-Salem office. [1] Regulation Best Interest, 83 Fed. Reg. 21574 (proposed May 9, 2018) (to be codified at 17 C.F.R. pt. 240). [2] *Id*. at 21575. [3] *Id.* at 21598. [4] *Id*. at 21599. [5] *Id*. [6] *Id*. at 21608. [7] *Id*. at 21617. [8] *Id*. [9] *Id*. at 21596. [10] *Id*.