SEC Passes Regulation Best Interest by 3-1 Vote

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By Melanie Waddell | June 05, 2019

SEC commissioners discussing Reg BI before voting. (Photo: Diego M. Radzinschi/ALM)

The Securities and Exchange Commission passed by a 3-1 vote Wednesday its controversial Regulation Best Interest, which SEC Chairman Jay Clayton said would “substantially enhance the broker-dealer standard of conduct beyond existing suitability obligations.”

The agency also passed by a 3-1 vote the three other prongs of the advice-standards package — the Form CRS Relationship Summary, the Standard of Conduct for Investment Advisers, and a new Interpretation of “Solely Incidental.”

SEC Commissioner Robert Jackson, a Democrat, dissented, stating that his hope was that the rules the SEC announced Wednesday would leave “no doubt that investors come first. Sadly, I cannot say that. Today’s rules maintain a muddled standard. Today’s rules simply do not require that investors’ interests come first.”

Jackson stated that he couldn't vote for any of the four prongs of the plan put forth Wednesday. Neither Reg BI nor the advisor recommendations "requires Wall Street to put investors' interest first," Jackson said.

(Related: A Timeline of the Contentious Fiduciary Rules (https://www.thinkadvisor.com/2019/06/03/a-timeline-of-the-contentious-fiduciary-rules/))

In his opening remarks, Clayton stated that "the overriding issue we address today — the obligations of financial professionals when they provide investment advice and services to retail customers — has been at the heart of our mission for those 85 years. This is a vast, multifaceted, complex and critically important facet of our economy and our society. It directly affects 43 million American households.

Today, Clayton said, "thanks to the career professionals here at the commission — and true to our mission — we elevate, enhance and clarify these obligations in a comprehensive manner."

He argued that the standard of conduct action "is long overdue. The fact that it is overdue does not make it easier. I believe the delay has made it more difficult as many interested parties have developed strident and divergent views on the state of the market, as well as current law and regulation, and what should be done to better serve the interests of our Main Street investors."

A complicating factor, Clayton continued, is "that we regulate two types of financial professionals that play important roles in this vast market — broker-dealers and investment advisers — but do so in significantly different ways and under different regulatory regimes."

Reg BI, Clayton said, "will substantially enhance the broker-dealer standard of conduct beyond existing suitability obligations, requiring broker-dealers, among other things, to act in the best interest of their retail customers when making a recommendation, including not placing their financial or other interests ahead of the interests of the retail customer."

Reg BI, he said, "draws from key fiduciary principles and cannot be satisfied through disclosure alone."

SEC Commissioner Hester Peirce, a Republican, commenting on the advice-standards package, urged attendees to "take a fair look at what the release actually says before you decide it's a success or a failure." In support of Reg BI, Peirce stated that the commission "must watch during the implementation process to see if we have properly calibrated the rule."

While Form CRS has been improved, more work needs to be done, she said.

Peirce added that the compliance period is "an ambitious one," and firms will have to start complying immediately. She will be open to requests for more time to comply for those firms showing diligent compliance.

Reg BI and Form CRS will become effective 60 days after they are published in the Federal Register, and will include a transition period until June 30, 2020 to give firms sufficient time to comply.

Knut Rostad, president of the Institute for the Fiduciary Standard, told ThinkAdvisor at the SEC meeting that it is a "catastrophe that will be remembered as black Wednesday. From the staff's descriptions, there's nothing materially different in the proposals other than they are using the word mitigation more often."

Reg BI, nearly 800 pages, differs from the original proposal issued last April in that it now applies to account recommendations, including recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA, and recommendations to take a plan distribution. It also applies to implicit "recommendations to hold" that result from agreed-upon account monitoring.

Reg BI also eliminates sales contests, sales quotas, bonuses and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

Reg BI also requires the following:

Disclosure obligation: Broker-dealers must disclose material facts about the relationship and recommendations, including specific disclosures about the capacity in which the broker is acting, fees, the type and scope of services provided, conflicts, limitations on services and products, and whether the broker-dealer provides monitoring services

Care obligation: The broker-dealer must establish, maintain and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate conflicts of interest. The obligation, which is an enhancement from the proposal, specifically requires policies and procedures to:

- Mitigate conflicts that create an incentive for the firm's financial professionals to place their interest or the interests of the firm ahead of the retail customer's interest;
- Prevent material limitations on offerings, such as limited product menu offering only proprietary products, from causing the firm or its financial professionals to place his or her interest or interests of the firm ahead of the retail customer's interest; and
- Eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

Compliance obligation: In an enhancement from the proposal, broker-dealers must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

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