



Getting the full picture

The emerging best interest and fiduciary duty patchwork

March 5, 2019

Proposed Regulation BI coverage of retirement investors

There is some debate about the intended scope of [Regulation Best Interest](#) (Regulation BI) as proposed by the Securities and Exchange Commission (SEC) in the case of retirement investors.

Generally, proposed Regulation BI would only apply when a broker-dealer is making a “recommendation” to a “retail customer” about a “securities transaction or an investment strategy involving securities.”

“Retail customer,” in turn, is defined under the proposal as “a person, or the legal representative of such person, who: (A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (B) Uses the recommendation primarily for personal, family, or household purposes.” From the proposing release, it is clear the SEC contemplated that participants in ERISA-covered plans (which logically also extends to participants in non-ERISA 403(b) programs and governmental retirement plans) and IRA owners would be retail customers when directing the investment of their retirement accounts, so long as a securities transaction was recommended.

- If Regulation BI is adopted, the SEC should acknowledge that the scope of the broker-dealer’s recommendation, and therefore of its best interest obligation, to a defined contribution plan participant is limited to the investment options available under the plan, and therefore qualitatively differs from recommendations in other retail contexts.
- As the release states, “[s]ecurities 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,” so long as the rollover entails the sale of securities held in the ERISA account and/or the purchase of securities in the IRA. If the investments held for the ERISA account and IRA are not securities, any recommendation would be out of scope.
- In the case of a defined benefit plan participant, any recommendation to elect a lump sum distribution (if available under the plan) and roll it over to the IRA would not seem to constitute a recommendation to the plan participant about a securities transaction, but any related recommendation about how to invest the IRA could potentially be considered a recommendation.
- A number of other interactions a broker-dealer might have with individual retirement investors – such as discussing a preferable retirement account type, the utility of increasing retirement contributions, the choices available for the investor’s plan account upon termination of employment with the plan sponsor, or the need to take a required minimum distribution if applicable – would not seem to rise to the level of a recommendation about a securities transaction.

The debate centers around the atypical reference to “legal representative” in the proposed retail customer definition. In the proposing release, the SEC points to trusts representing natural persons as the exemplar of such a legal representative. Some commentators have seized upon that reference to argue that plan sponsors or other fiduciaries acting for the plan as whole and not for participants individually – e.g., in selecting investment options for a defined contribution plan or managing the assets of a defined benefit plan – are or should be treated as “retail customers” for this purpose.

It seems clear, however, that Regulation BI was not designed for the plan sponsor setting. The SEC specifically observed in the proposing release that the regulation is inapplicable to “recommendations that are primarily for business purposes (such as any recommendations to institutions),” as distinguished from “personal, family, or household purposes.” Plan investment activity undertaken by the sponsor or plan fiduciary occurs with reference to the institutional needs of the plan as a whole, not with reference to the personal, family or household needs of particular participants individually. In addition, the “retail investor customer profile,” a key compliance concept under the proposal, is inapt to plan sponsor-level interactions by broker-dealers. Any extension of Regulation BI to plan sponsors thus would require a major rethinking not only of the intended scope of the proposal, but also of the operation of its standards.

Contacts

For more commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland’s www.secfiduciaryrule.com.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Eversheds Sutherland attorney with whom you regularly work.

Mark Smith, *Partner*

T: +1 202 383 0221

marksmith@eversheds-sutherland.com

Adam Cohen, *Partner*

T: +1 202 383 0167

adamcohen@eversheds-sutherland.com

Carol McClarnon, *Partner*

T: +1 202 383 0946

carolmclarnon@eversheds-sutherland.com

Related people/contributors

- Eric Arnold
- Michael Koffler
- Cynthia Shoss
- Bria Adams
- Wilson Barmeyer
- Susan Krawczyk
- Holly Smith
- Sarah Sallis
- Bruce Bettigole
- S. Lawrence Polk
- John Walsh
- Amber Unwala
- Olga Greenberg
- Stephen Roth
- Issa Hanna
- Clifford Kirsch
- Brian Rubin
- Ben Marzouk

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