

Digging into the SEC's Final RIA Guidance – And Why It Repeatedly Uses the Term “Best Interest”

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In light of the significance of the final rules and commission interpretations issued by the Securities and Exchange Commission (SEC) on June 5, 2019, Drinker Biddle & Reath's Best Interest Compliance Team is publishing a series of articles on the subject. The first article, [The Final Reg BI Package: What to Know and What's Next](#),” summarized the final package of rules and interpretations. The second article covered “[Form CRS](#).” This third article conducts a more detailed analysis of strategically selected provisions of the Commission Interpretation Regarding Standard of Conduct for Investment Advisers (RIA Guidance).

Background

In summary, the RIA Guidance reaffirms, interprets, clarifies, and provides guidance regarding the fiduciary duty an investment adviser owes to its clients under the Investment Advisers Act of 1940 (Advisers Act) as it has been interpreted by common law and SEC guidance. The RIA Guidance provides that this duty is principles-based and applies to the entire relationship between an investment adviser and the client. In essence, with the RIA Guidance the SEC has consolidated these long-recognized, court-established fiduciary duties into this interpretive release.

The RIA Guidance also describes the underlying duties that constitute an investment adviser's fiduciary duties: the Duty of Care and the Duty of Loyalty. It further breaks down the Duty of Care as follows: (i) a Duty to Provide Advice that is in the *Best Interest* of the Client, (ii) a Duty to Seek Best Execution, and (iii) a Duty to Provide Advice and Monitoring over the Course of the Relationship. (*Emphasis added.*) The discussion of the “Duty to Provide Advice that is in the *Best Interest* of the Client” includes a subsection with a detailed discussion of the requirement for a “reasonable belief that advice is in the *best interest* of the client.” (*Emphasis added.*)

With that background in mind, this article will focus on:

- The significance of the Commission-level release of this RIA Guidance for the industry
- The applicability of the RIA Guidance to advice on account type, including rollovers
- What the RIA Guidance provides regarding cost versus SEC staff views
- The RIA Guidance on the use of general terms, such as “may”
- The convergence of standards, with the RIA Guidance repeatedly using the term “Best Interest,” and “Reg BI” requiring disclosures of material conflicts of interest.

An Overdue Commission-Level Pronouncement on the Standard of Conduct

The RIA Guidance readily confirmed that the Advisers Act does not provide for a fiduciary standard in its statutory text or in the text of the rules promulgated thereunder. Specifically, the RIA Guidance states that “The relationship between an investment adviser and its client has long been based on fiduciary principles not generally set forth in specific statute or rule text.” [SEC, 17 CFR Part 276 \(Release No. IA-5248; File No. S7-07-17, page 5\)](#).

Indeed, the RIA Guidance starts with a citation to the 1963 Supreme Court opinion in *SEC v. Capital Gains Research Bureau Inc.* and selected references to certain SEC releases, without any direct citation to the language of the Advisers Act. (*Id.*, p. 2, fn 2.) This background elevates the RIA Guidance to the most significant Commission pronouncement on the fiduciary duties of an investment adviser ever finalized and published by the SEC. For this reason, investment advisory firms should scrutinize and analyze the RIA Guidance, apply it to their firm, and remediate any issues with enhanced practices, policies, and procedures as soon as is reasonably possible. Indeed, unlike Reg BI and Form CRS that have an implementation date of June 30, 2020, the RIA Guidance became effective on July 12, 2019.

In addition to providing historical and general guidance on the standard of conduct for investment advisers, the RIA Guidance provides specific interpretive guidance that we discuss below.

The RIA Guidance Applies to Advice on Selection of Account Types, Including Rollovers

The RIA guidance makes clear that an adviser’s fiduciary duty applies to “all investment advice the investment adviser provides to clients” including account type. Regarding account type, the guidance continues:

Advice about account type includes advice about whether to open or invest through a certain type of account (e.g., a commission-based brokerage account or a fee-based advisory account) and advice about whether to roll over assets from one account (e.g., a retirement account) into a new or existing account that the adviser or an affiliate of the adviser manages. In providing advice about account type, an adviser should consider all types of accounts offered by the adviser and acknowledge to a client when the account types the adviser offers are not in the client’s best interest. (*Id.*, p. 18, footnote omitted.)

Regarding rollovers, the RIA Guidance offers more specificity: “We consider advice about ‘rollovers’ to include advice about account type, in addition to any advice regarding the investments or investment strategy with respect to the assets to be rolled over, as the advice necessarily includes the advice about the account type into which assets are to be rolled over.” (*Id.*, p. 18, fn 42.) Thus, the SEC appears likely to increase its scrutiny of investment advisers’ practices relating to rollovers.

Lowest-Cost Recommendations versus Higher-Cost Recommendations

The RIA Guidance reaffirms the recognized view (of at least the SEC policy divisions) that recommending the lowest-cost product or strategy is not required. This aspect of the guidance, however, needs to be tempered by the reality that many of their fellow staff members in the Division of Enforcement and the Office of Compliance Inspections and Examinations have historically regularly departed from the policy divisions’ view through their investigative and examination tactics with registrants and continue to do so.

The RIA Guidance specifically provides that “when considering similar investment products or strategies, the fiduciary duty does not necessarily require an adviser to recommend the lowest cost investment product or strategy.” (*Id.*, p. 17.) However, the RIA Guidance goes on to state that for situations in which the lowest-cost investment or strategy is not recommended, there should be consideration of “other factors about the investment or strategy that outweigh cost and make the investment or strategy in the best interest of the client, in light of that client’s objectives.” (*Id.*) Unfortunately, the SEC chose not to provide more details on the other factors that should be considered. Firms need to be vigilant that their compliance and supervisory practices, policies, and procedures are strong in this area, and further that the recommendations made to place a client in a higher-cost investment or strategy are fully supportable and well documented.

Use the Dreaded Disclosure Term “May” at Your Own Peril

The RIA Guidance also offers a Commission-level perspective on what now should be aptly described as the dreaded disclosure term “may.” The use of this general term “is not adequate when the conflict actually exists.” (*Id.*, p. 25.) Further, the use of this term would be inappropriate if it simply precedes a list of all possible or potential conflicts and “obfuscates actual conflicts to the point that a client cannot provide informed consent.” (*Id.*) In response to a comment letter, the SEC provides a sentence in passing (and perhaps somewhat begrudgingly) that this term “could” be used appropriately to disclose a conflict that currently does not exist but might in the future. (*Id.*) It is unclear how much comfort this provides, so a takeaway for firms that plan to continue to use the term “may” ? and any other type of broad and general terminology to discuss actual existing conflicts – is that they will be doing so at their own peril.

The Convergence of the Standards of Conduct

The RIA Guidance uses the term “best interest” repeatedly throughout the final release for a total of 51 times. While, like Reg BI, the Guidance does not define this term, it does have a subsection that discusses guidance for complying with the “Duty to Provide Advice that is in the Best Interest of the Client.” The RIA Guidance does not discuss this connection between the RIA Guidance and Reg BI, however, though it appears to be fairly palpable.

Going in the other direction, the Reg BI final rule comprises four “obligations,” including the “Disclosure Obligation” and the “Conflict of Interest Obligation.” The RIA Guidance repeatedly discusses in a multitude of ways the long-standing duties of an investment adviser to disclose material conflicts of interest to satisfy the well-accepted fiduciary duty owed to advisory clients. Certain critics of the SEC’s efforts have complained about the lack of a uniform fiduciary standard. Regardless of whether that criticism has any merit, closer analyses of these aspects of this final rulemaking package reveal that the standards of conduct for the brokerage and the investment advisory industries to service their retail clients have converged, and some “may” argue significantly so.

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