

# GOVERNMENT RELATIONS POLICY POSITION PAPER

## Harmonization of the Best Interest Standard

### The issue

In 2019, the SEC finalized Regulation Best Interest (“Reg BI”), effective June 30, 2020, which requires broker-dealers to act in their customers’ best interest and provide full and fair disclosure of material facts and conflicts of interest with respect to securities. In addition, the National Association of Insurance Commissioners (“NAIC”) has adopted a Model Rule requiring annuity recommendations to be similarly in the best interest of the customer. Together, these two pieces of guidance lay the groundwork for a uniform and formidable set of rules that require all financial professionals to act in the best interest of their customers. We are now working to ensure that this sound structure is preserved.

### Current status

Three potential concerns exist that could disrupt this sound structure. First, there is a concern with respect to current and possible future guidance from the Department of Labor.

In 2016, the U.S. Department of Labor (DOL) finalized a new set of fiduciary rules that made it extremely burdensome and risky to provide brokerage advice, leading to millions of low and middle-income Americans losing access to brokerage services. Unfortunately, this meant that these Americans generally lost access to personalized investment assistance with respect to their retirement savings. Low and middle-income individuals generally do not have access to advisory accounts – which are the only alternative means of obtaining personalized assistance – since those accounts generally require significant account minimums. These account minimums are needed to justify the cost of advisory accounts which, unlike brokerage accounts, impose an ongoing and constant fiduciary duty to review investments. However, on March 15, 2018, the Fifth Circuit Court of Appeals vacated the DOL rule in whole, effectively killing it and ending its adverse effects.

Recently, on December 18, 2020 the DOL finalized a new set of standards that would, in the preamble, revive much of the harmful 2016 package. However, preambles are not the law, and questions have been raised regarding whether the preamble is valid under the law. If the preamble is valid, it would seriously disrupt the carefully designed best interest rules established by the SEC and the NAIC and would again lead to far less access to advice. The preamble, and a new prohibited transaction exemption, are under a temporary non-enforcement policy until December 2021.

Moreover, not only do the preamble and new exemption pose challenges, but also DOL has indicated explicitly that it anticipates continuing to make changes to both the definition of a fiduciary and the exemption through both regulatory and sub-regulatory guidance. For example, in April of 2021, DOL issued FAQs imposing further restrictions under the exemption and resurrecting a number of provisions from the harmful 2016 fiduciary rules. Additional sub-regulatory guidance could be issued at any time.

In addition, there have been numerous signals that the current Presidential Administration may explore making regulatory changes that further revive much of the harmful 2016 fiduciary rules. These regulatory changes could take a few years to become effective, but this is a very real and serious threat to the availability of investment assistance. In addition, the continual changes to the fiduciary rules trigger substantial administrative costs that are borne by investors as well as confusion for investors who must adjust to changing communications and modes of assistance.

Second, it is possible that the SEC will revisit Reg BI and incorporate aspects of the DOL fiduciary rule, including treating broker-dealers as fiduciaries. This would likely trigger many of the adverse effects of the 2016 DOL rule. Gary Gensler, the Chairman of the SEC, has been vocal about the need for strong fiduciary standards in the past and may pursue changes to Reg BI.

Reg BI is exactly what investors need – a clear administrable requirement that broker-dealers act in their clients' best interest. This protects investors and, unlike the 2016 DOL fiduciary rules, ensures that investors can continue to use brokerage services if they want to.

The third threat comes from state legislatures and regulators, some of which have adopted – or are considering adopting -- new fiduciary rules applicable to securities that could create a patchwork of inconsistent rules that would increase compliance costs dramatically, and also undermine the brokerage model, which is the main source of advice and assistance for low and middle-income investors. We have seen several states act on their own fiduciary or best interest standards, including Iowa, Massachusetts, Nevada, New Jersey, New York, and Oklahoma. At this point, only Massachusetts has issued a final fiduciary regulation that financial professionals must comply with, which created new burdens and risks. Nevada enacted a statute in 2017 that requires broker-dealers and securities agents to be subject to a fiduciary standard. However, the Nevada Secretary of State has not finalized the regulations surrounding the obligation. New Jersey has formally proposed regulations, but they are not yet finalized due to the coronavirus pandemic. The threat is that actions like this will continue to proliferate among states across the country.

On the other hand, the best thing for states to be doing is defer to the SEC with respect to the regulation of securities and to adopt the NAIC model rule on annuity products, so that we can move closer to a uniform clear best interest standard for annuities to supplement the SEC's best interest standard for securities. Several states have already passed legislation or regulation to adopt the model rule for annuity products. Going forward, additional states will begin the process of adopting the model rule. It is noteworthy that a New York regulation applying a non-NAIC model best interest standard to annuities has been invalidated as unconstitutionally vague.

## **LPL position**

LPL has long supported regulations requiring that investment advice be in the investor's best interest. We have consistently voiced our support for standards that will protect investors by helping to ensure that they receive investment advice and recommendations that are fair and appropriate for their particular investment, savings and financial needs. We also believe it is important that financial institutions and professionals provide clear disclosures regarding the nature of their services, their fees and compensation, and material conflicts of interest so that investors can make informed choices about investment services and products.

At the same time, we have urged that such standards and requirements be adopted in a way that preserves investor choice and access to a wide range of investment and financial services. Harmonized best interest standards will reduce investor confusion and costs, facilitate compliance, and promote holistic investment services, advice and planning. This will result in better savings and investment outcomes for all Americans, regardless of whether they are saving through a tax-qualified retirement account or a taxable account, and regardless of whether they receive advice from a broker-dealer or an investment adviser.

LPL has been very supportive of the SEC's efforts to date in adopting Reg BI. As the prudential regulator for broker-dealers and investment advisers, the SEC was best positioned to engineer such a comprehensive rule. Furthermore, the SEC has the mechanisms in place to enforce this best interest standard, which would do so much to protect all retail investors.

We will continue to work with the SEC and DOL while also engaging proactively with state legislatures and regulators through individual meetings, comment letters and testimony. During our outreach, we emphasize the need for a single standard of conduct; it is untenable for financial advice to be subject to conflicting standards from the SEC, DOL, the states, and possibly even cities and counties. We need a clear harmonized best interest standard.

We look forward to our continued partnership with Congress, our regulators, and our industry partners to work in concert with existing obligations to protect American investors. Through our advocacy efforts, LPL will continue to push for a thoughtful resolution of this complex issue so that we may end the lingering uncertainty for our advisors and our collective business.

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