The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 32728**

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# SEC Staff Issues Additional FAQs on Regulation Best Interest

[32728]

September 1, 2020 TO: ICI Members
Investment Company Directors
Broker/Dealer Advisory Committee
Investment Adviser and Broker-Dealer Standards of Conduct Working Group
Investment Advisers Committee
Operations Committee
Pension Committee
SEC Rules Committee
Transfer Agent Advisory Committee SUBJECTS: Compliance
Disclosure
Investment Advisers
Operations RE: SEC Staff Issues Additional FAQs on Regulation Best Interest

The SEC staff recently issued additional "Frequently Asked Questions" (FAQs) on Regulation Best Interest ("Reg BI"), which the SEC adopted, along with Form CRS, in June 2019 as part of its standards of conduct rulemakings.[1] The staff's recent FAQs are summarized below.[2]

## Care Obligation

### Rollover and Transfer Recommendations

The SEC staff confirmed that, when recommending that a retail customer roll over or transfer assets, such as from a brokerage account to an advisory account, a dually registered financial professional must have a reasonable basis to believe that the recommendation is in the retail customer's best interest at the time of the recommendation and does not place the financial professional's interest ahead of that of the retail customer. In doing so, the financial professional must weigh the potential risks, rewards, and costs of a particular security or investment strategy, in light of the particular retail customer's investment profile.

The staff stated that prior to making such a recommendation, the financial professional should consider, among other factors, the potential risks, rewards, and costs associated with the transfer or rollover of the securities, including whether the transfer or rollover would require a sale of securities. This would include considering any fees and costs related

to any sale of the securities, such as deferred charges or liquidation costs. Moreover, the staff pointed out that the financial professional must consider the potential risks, rewards, and costs associated with the advisory account, and weigh such factors in light of the particular retail customer's investment profile, as well as other relevant factors.

The staff included the example of a retail customer that holds class A mutual fund shares, noting the considerations that a broker-dealer should weigh in determining whether a recommendation to roll over or transfer class A shares is in the customer's best interest. These considerations include the possibility that the sale of the shares could generate a taxable event for the customer and could result in losing certain benefits, such as rights of accumulation or rights of exchange, and that class A shares typically charge a front-end sales load, but tend to have lower 12b-1 and other ongoing fees and expenses.

Further, the staff noted that, where a retail customer holds a variety of investments or prefers differing levels of services (*e.g.*, both episodic recommendations from a broker-dealer and continuous advisory services from an investment adviser), it may be in the retail customer's best interest for the broker-dealer to recommend both a brokerage and an advisory account.

### Determining the Capacity in Which a Dual Registrant Makes a Recommendation

The staff clarified that determining the capacity of a dual registrant when making a recommendation requires a facts and circumstances analysis. Relevant considerations include, among others, the type of account, how the account is described, the type of compensation, and the extent to which the dual registrant made clear to the customer the capacity in which it was acting.

The staff stated that Reg BI would not apply when a dual registrant, acting in the capacity of an investment adviser, provides investment advice to a retail customer, even if it executes the transaction in its brokerage capacity or the customer has a brokerage relationship with the dual registrant. The staff explained that a dual registrant is an investment adviser solely with respect to those accounts for which it provides investment advice or receives compensation that subjects it to the Investment Advisers Act of 1940 ("Advisers Act").

Further, the staff noted that where a dual registrant does not yet know and has not clearly disclosed the capacity in which it acts regarding a potential retail customer, such as the initial recommendation of a brokerage or advisory account, the dual registrant should assume that both Reg BI and the Advisers Act would apply, and the account recommendation generally should be evaluated under both Reg BI and the Advisers Act.

## Retail Customer

### Financial Industry Professional Acting for His Own Account

The SEC staff confirmed that Reg BI applies where a broker-dealer makes a recommendation of a securities transaction or investment strategy involving securities, to a regulated financial services industry professional acting in a personal capacity for his or her own account. The individual would be considered a "retail customer" for purposes of Reg BI, as he or she would be a natural person receiving and using the recommendation for personal, family, or household purposes.

## Disclosure Obligation

### Broker-Dealer Use of Issuer-Prepared Materials Describing Financial Professionals as “Advisers” or “Advisors”

The SEC staff confirmed that, where a broker-dealer uses or distributes issuer-prepared materials, such as a prospectus, that generally refer to financial professionals as “advisers” or “advisors,” such disclosure, by itself, would not presumptively violate the capacity disclosure requirement under Reg BI’s Disclosure Obligation. This would be the case regardless of whether the broker-dealer is dually registered or the associated persons of the broker-dealer are also supervised persons of an investment adviser.

However, the staff emphasized that to satisfy the Disclosure Obligation when making a recommendation, broker-dealers must make full and fair disclosure of all material facts related to the scope and terms of the relationship with a retail customer. Thus, additional disclosures to identify the capacity in which they are acting when making a recommendation may be necessary for the firm and the financial professional using the issuer materials (*e.g.*, where a financial professional who is not also a supervised person of an investment adviser uses such issuer materials when making a recommendation).

### Standalone Broker-Dealer’s Use of “Adviser” or “Advisor” in Firm’s “Doing Business as” or “Marketing” Name

The staff noted that the SEC presumes a violation of the Disclosure Obligation under Reg BI when (i) a broker-dealer that is not also a registered investment adviser or (ii) an associated person of a broker-dealer that is not also a supervised person of an investment adviser, uses the term “adviser” or “advisor” in its name or title. The staff pointed out that this presumption applies to a firm’s “doing business as” or “marketing” name, as well as a firm’s legal name.

### Standalone Broker-Dealer’s Use of “Adviser” or “Advisor” in Firm’s Marketing Materials

The SEC staff confirmed that a standalone broker-dealer’s use or distribution of firm materials, such as marketing materials that generally refer to the firm’s financial professionals using the terms “advisers” or “advisors,” would presumptively violate the capacity disclosure requirement under Reg BI’s Disclosure Obligation. However, the staff stated that a financial professional who is also a supervised person of an investment adviser may use his or her own materials (or materials that the registered investment adviser prepared) that refer to himself or herself as an “adviser” or “advisor.”

### Dually Registered Broker-Dealer’s Use of “Adviser” or “Advisor” in Firm’s Marketing Material

The staff clarified that where a dually-registered broker-dealer uses or distributes firm material referring to financial professionals using the terms “advisers” or “advisors,” such language, by itself, would not presumptively violate the capacity disclosure requirement under the Disclosure Obligation. This would be the case whether or not the financial professional using the firm’s materials is also a supervised person of an investment adviser.

However, the staff highlighted that, to satisfy the Disclosure Obligation when making a recommendation, broker-dealers and persons associated with broker-dealers must make

full and fair disclosure of all material facts relating to the scope and terms of the relationship with the retail customer, including the capacity in which they are acting with respect to the recommendation. The staff stated that additional disclosures to identify capacity may be necessary for the firm and the financial professional using such firm materials when making a recommendation (*e.g.*, where a financial professional who is not also a supervised person of an investment adviser uses such firm materials when making a recommendation).

Additionally, the staff stated that a financial professional who is not a supervised person of an investment adviser may not use his or her own materials that refer to himself or herself as an "adviser" or "advisor," regardless of his or her firm's registration status.

**Dual-Hatted Broker-Dealer-Bank Employee's Use of the Terms "Adviser" or "Advisor"**

Finally, the SEC staff confirmed that Reg BI would not apply when a dual-hatted broker-dealer-bank employee (*e.g.*, an associated person of a broker-dealer who also offers services on behalf of a bank) acts in the capacity of a bank employee. The staff explained that Reg BI applies only in the context of a brokerage relationship with a brokerage customer, and specifically, when making a recommendation in the capacity of a broker-dealer.

Nevertheless, the staff noted that, where a dual-hatted broker-dealer-bank employee provides a recommendation to a retail customer in his or her broker-dealer capacity, the use of the name or title of "adviser" or "advisor" would presumptively violate the Disclosure Obligation. This would be the case unless such individual is also a supervised person of an investment adviser.

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**endnotes**

[1] The FAQs, which were prepared by the staff of the SEC's Divisions of Investment Management and Trading and Markets, are *available at* https://www.sec.gov/tm/faq-regulation-best-interest. For a detailed summary of the SEC's rulemakings, *please see* the attachments to ICI Memorandum No. 31815 (June 19, 2019), *available at* https://www.ici.org/my_ici/memorandum/ci.memo31815.idc. The implementation date of Reg BI and Form CRS was June 30, 2020.

[2] The SEC staff last updated the FAQs on Form CRS on June 29, 2020, and these updates are *available at* https://www.sec.gov/investment/form-crs-faq. For prior ICI summaries of the staff's FAQs on Reg BI and Form CRS, *please see* ICI Memorandum No. 32068 (Nov. 27, 2019), *available at* https://www.ici.org/my_ici/memorandum/memo32068; ICI Memorandum No. 32164 (Jan. 21, 2020), *available at* https://www.ici.org/my_ici/memorandum/memo32164; ICI Memorandum No. 32219 (Feb.

19, 2020), *available at* https://www.ici.org/my_ici/memorandum/memo32219; ICI Memorandum No. 32423 (Apr. 28, 2020), *available at* https://www.ici.org/my_ici/memorandum/memo32423; ICI Memorandum No. 32585 (July 7, 2020), *available at* https://www.ici.org/my_ici/memorandum/memo32585.

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