

MEMO# 34100

April 6, 2022

SEC Staff Issues Guidance on Investment Adviser and Broker Dealer Standards of Conduct

[34100]

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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

Distribution

Fees and expenses

Intermediary oversight

Trading and markets

Operations

Pension

Recordkeeping

Transfer agent RE: SEC Staff Issues Guidance on Investment Adviser and Broker Dealer Standards of Conduct

Recently, the staff of the Securities and Exchange Commission issued a bulletin on the application of the standards of conduct applicable to broker-dealers and investment advisers (both, "financial professionals") when recommending account types for retail investors.[\[1\]](#) The staff guidance touches on both Regulation Best Interest ("Reg BI") for broker-dealers and the fiduciary standard for investment advisers under the Investment Advisers Act (the "IA fiduciary standard"). The staff notes that both standards include an obligation to act in a retail investor's best interest. While the staff clarifies that the bulletin is not a "rule, regulation, or statement of the Commission," the guidance provides some areas of notable interpretation of the 2019 Reg BI rulemaking and Commission

interpretation on the IA fiduciary standard.[\[2\]](#)

Key points from the bulletin include:

- **More than one standard of conduct may apply to dually-licensed financial professionals making account type recommendations:** The staff states that, while the standard that financial professionals must follow depends on the capacity in which they are acting (i.e., broker-dealer, investment adviser, or both), in many cases, both Reg BI and the IA fiduciary standard may apply as a professional assesses an account type recommendation for a current or prospective retail investor. Particularly, where financial professionals have not yet established the capacity in which they will be acting, they should assume that both standards apply and disclose to the investor, prior to or at the time of the recommendation, that they are acting in both capacities.
- **Consideration of sufficient information about a retail investor:** The staff believes that financial professionals should obtain and evaluate sufficient information about a retail investor to be able to form a reasonable basis that an account type recommendation is in the retail investor's best interest. The staff recommends that financial professionals consider, without limitation, the retail investor's:
 - financial situation (including current income) and needs;
 - investments;
 - assets and debts;
 - marital status;
 - tax status;
 - age;
 - investment time horizon;
 - liquidity needs;
 - risk tolerance;
 - investment experience;
 - investment objectives and financial goals; and
 - any other information the retail investor may disclose to the financial professional in connection with an account recommendation.

The staff also believes that financial professionals should consider, without limitation, the retail investor's:

- anticipated investment strategy e.g., buy and hold versus more frequent trading);
 - level of financial sophistication;
 - preference for making their own investment decisions or relying on advice from a financial professional; and
 - need or desire for account monitoring or ongoing account management.
- **Consideration of costs:** The staff states that financial professionals must always consider cost as a factor when making an account recommendation, including:
 - account fees (e.g., asset-based, engagement, hourly);
 - commissions and transaction costs (e.g., markups and markdowns);
 - tax considerations;
 - indirect costs, such as those associated with payment for order flow and cash sweep programs;
 - fees associated with the investment products that are available through the account, such as the internal expenses of funds, including management fees, distribution, and servicing fees; and
 - the costs of investing in funds, including front-end and back-end fees.

The staff believes that financial professionals recommending higher cost accounts must have a reasonable basis to believe the account recommendation is nonetheless in the retail investor's best interest based on other factors and in light of the particular situation and needs of the retail investor.[\[3\]](#)

- Consideration of investor preferences for a particular account type: Although the staff advises financial professionals that a retail investor's preference for a particular type of account should be considered, the staff notes that professionals would not satisfy their standards of conduct in basing an account type recommendation on a retail investor's preference alone. Financial professionals have an obligation to consider reasonably available alternatives and recommend an account they reasonably believe is in the retail investor's best interest. In the staff's view, however, if the retail investor ultimately directs a professional to open an account that is contrary to the recommendation, the professional would not be required to refuse to accept the investor's direction.
- **Consideration of limited product menus:** The staff states that financial professionals cannot recommend an account that is not in a retail investor's best interest solely based on their firm's limited product menu or limitations on professional licensing. Any limitations on account types considered, in the staff's view, are material facts that should be disclosed (along with other relevant material facts, including services, fees, and conflicts of interest) to retail investors.
- Additional considerations when making a rollover recommendation: In addition to the factors discussed above, the staff believes that there are specific factors that financial professionals should generally consider when making a rollover recommendation[\[4\]](#) to a retail investor, including, without limitation:
 - level of services available;
 - features of the existing account, including costs;
 - available investment options;
 - ability to take penalty-free withdrawals; application of required minimum distributions;
 - protection from creditors and legal judgments; and
 - holdings of employer stock.
- Consideration of employer plan in making rollover recommendation: In the staff's view, it would be difficult for financial professionals to form a reasonable basis to believe that a rollover recommendation is in a retail investor's best interest, and does not place the professional or firm's interests ahead of the retail investor's interest, if the professional does not consider the alternative of leaving the retail investor's investments in an employer plan, where that is an option. To evaluate any recommendation to transfer assets out of an employer plan, or between individual retirement accounts, financial professionals would need to obtain information about the existing plan, including the costs associated with the options available in the investor's current plan.
- Documentation of account type recommendations: It is the staff's view that it may be difficult for a firm to assess the adequacy and effectiveness of its policies and procedures or to demonstrate compliance with its obligations to retail investors without documenting the basis for its conclusions.

Notes

[1] See Staff Bulletin: [Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors](#) (March 30, 2022).

[2] See [Regulation Best Interest: The Broker-Dealer Standard of Conduct](#), Exchange Act Release No. 86031, 84 FR 33318 (June 5, 2019); [Commission Interpretation Regarding Standard of Conduct for Investment Advisers](#), Investment Advisers Act Release No. 5248, 84 FR 33669 (June 5, 2019).

[3] The staff also provides examples of considerations other than costs, including the investor's need for certain services or certain types of investment products or strategies that are only available in certain account types; the account's characteristics, including any special or unusual features requested by the retail investor, such as tax advantages; potential benefits and risks; time horizon; and anticipated composition of investments in the investment account.

[4] The staff reminds retail professionals that some rollovers also are subject to regulation by the Department of Labor. The staff recommends that professionals relying on Prohibited Transaction Exemption 2020-02 review guidance from the Department of Labor on factors to consider in making a rollover recommendation, as well as relevant documentation requirements.