

EMPYRION™

WEALTH MANAGEMENT



Monthly Insight

The "Best Interest" Standard: Does It Really Mean That?

Readers of a certain age remember how, in the movie *The Princess Bride*, Vizzini, villainous kidnapper of Princess Buttercup, habitually exclaimed, “Inconceivable!” when he encountered a situation he considered unlikely to materialize. And yet, over and over again, the precise events that he found impossible to credit would occur. At one

point, after seeing yet another “inconceivable” thing take place, Inigo Montoya, one of his henchmen, turned to him and said, “You keep using that word. I do not think it means what you think it means.”

In much the same way, the new “Best Interest” standard enacted in June 2019 by the Securities and Exchange Commission (SEC) — commonly referred to as “Reg BI” — may not mean what many investors assume it means. While intended to elevate the required baseline for investment recommendations from the former “suitability” level to a requisite that mandates acting in the customer’s best interest, many aspects of this new standard have the potential to create greater confusion among investors as to what type of investment service and advice they are receiving. It may also confuse issues around how investors pay for their advice and the degree to which conflicts of interest are minimized or eliminated.

The origins of Reg BI can be traced to the Obama administration, when the Department of Labor (DOL) set forth what became known as the “fiduciary rule,” requiring anyone providing investment advice for retirement accounts to offer recommendations that met the fiduciary standard of placing the client’s interests above those of the advisor. Among other things, the fiduciary standard required full disclosure of all fees and commissions related to the sale of a product or service. It also required complete disclosure and, where possible, avoidance of conflicts of interest. The brokerage industry objected strenuously to the DOL rule, claiming that it placed an unfair burden on broker-dealers, many of whom are compensated by commissions on the sale of products and services. As a result, the Trump administration placed a hold on implementation of the fiduciary rule until the completion of a period of review and public comment.

Reg BI is the result of that period of review and public comment, an attempt by the SEC to balance the interests of consumers with the economics of the brokerage industry. The opinion of many of us in the

financial advisory business is that Reg BI does more to benefit broker-dealers than it does to protect investors and clients.

Reg BI: What Exactly Does "Best Interest" Mean?

First, and perhaps most importantly, although the new standard is described as acting in the client's best interest, nowhere does the regulation define precisely what "best interest" means. In contrast to the "duty of loyalty" obligation requiring financial advisors with the Certified Financial Planner® (CFP®) designation to provide fiduciary advice that puts the client's interest ahead of the advisor's, Reg BI's "best interest" language is rather vague and extends only to recommendations for products or strategies involving products. In fact, because broker-dealers are not allowed to provide comprehensive financial advice other than making such recommendations, Reg BI also seems likely to confuse investors about the type of advice they may obtain.

Additionally, Reg BI takes a different tack with regard to conflicts of interest between the broker-dealer and the client. While the "duty of loyalty" required by the fiduciary standard mandates that CFP® certificants must avoid or disclose and actively mitigate conflicts of interest, Reg BI relies more heavily on simple disclosure of the conflicts as sufficient. As Barbara Roper, director of investor protection for the nonprofit Consumer Federation of America, has written, the fiduciary standard "makes clear that, even after conflicts of interest have been disclosed and consented to, the CFP® certificant still has an obligation to set those conflicts aside and put the client's interests first. That's what investors reasonably expect from someone pledged to act in their best interests."

Indeed, Roper's comment gets at the heart of the difference between the type of relationship investors and clients have with a broker-dealer as compared to that with a professional, certified, fiduciary financial

advisor. In the first place, it is primarily a sales relationship in which the broker-dealer makes recommendations for products to be purchased or for implementation of strategies involving those products. In the second place, it is an advisory relationship in which the financial planner or advisor provides all-inclusive counsel to help the client reach their financial, philanthropic, and other important goals. Even after Reg BI, the dynamic between the client and the broker-dealer will be primarily oriented toward the purchase of products. By comparison, the client's relationship with the fiduciary advisor will be primarily concerned with charting a long-term course toward financial security.

In the final analysis, the principal danger with Reg BI is that it is likely to blur the important differences between working with a certified, professional, fiduciary advisor and purchasing products from a broker-dealer. While it is true that both providers will be nominally held to the standard of working in the client's "best interest," there is a huge contrast between someone who sells products and a certified, fiduciary professional who provides guidance, advice, and solutions for a broad range of financial needs.

We are committed to the fiduciary standard; it is the foundation of all our communications, every client relationship, and each product or service that we recommend. We believe that commitment enables us to serve our clients with transparency, integrity, and the highest professional principles. If you would like to learn more about how a certified, fiduciary financial advisor can help you reach your goals, we would appreciate the opportunity to explain in greater detail the services we offer.

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