NAIFA GovTalk

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June 2019

SEC Finalizes Standard of Care Rules for Broker-Dealers

On June 5, the Securities and Exchange Commission (SEC) finalized new standard of care rules for broker-dealers and their registered representatives. The new rules impose a "best interest of the retail client" standard of care on broker-dealers and their registered representatives. They include new disclosure requirement--pertaining to fees, costs, types of services provided and the scope of the relationship between the advisor and the investor--that add on to existing disclosure obligations.

The final rules come in four parts:

- The Regulation Best Interest (Reg BI), new standard of care rules for broker-dealers
- The Form CRS (a disclosure form to be given to customers early in the relationship)
- An interpretation of the existing "solely incidental" exception for broker-dealers under the Advisers Act
- An interpretation of the investment advisor's fiduciary duty under the Advisers Act

In several areas the final rules reflect input from NAIFA provided in comments and at meetings with SEC commissioners throughout the rulemaking process. The final rules do contain some modifications and clarifications as compared to the rules that were initially proposed in April, 2018, but largely reflect the proposed rules.

Most of the compliance burden from these new final rules will fall on broker-dealers (and investment advisor firms), rather than on individuals. For example, it is expected that broker-dealers and investment advisor firms will develop and provide to their sales forces the required disclosure Form CRS. It is, therefore, very important that NAIFA members carefully follow the direction and requirements provided by their broker-dealers and investment advisor firms.

Best Interest of the Client: Reg BI imposes a "best interest of the retail client" standard of care on broker-dealers and their registered representatives. The rule does not define "best interest;" instead it lists actions that when taken indicate that the client's best interest is coming first.

Generally, under the rule, the best interest standard requires broker-dealers and their representatives, when recommending securities strategies or transactions to a retail customer, to act in the customer's best interest at the time the recommendation is made and not place the interests of the BD or its representative ahead of the customer's interest. To flesh out this requirement, considerable disclosure (particularly relative to actual or potential conflicts of interest) to customers by both investment advisors and broker-dealers is required, much of it to be provided through the required Form CRS.

Form CRS: The required disclosures build on already-required disclosures, and must be clear, simple and easy for a customer to understand. The required disclosures include product cost, fees, type and scope of services to be provided, the nature of the relationship with the client and material conflicts of interest associated with any recommendation made.

Of specific interest: cost of the product being recommended is a factor that always must be disclosed—but it is not the only factor in determining whether a recommendation meets the best interest standard. It is clear from the SEC rules that a recommendation need not be for the least expensive product, but that cost must always be disclosed. The rules specify that neither the client nor the broker-dealer can waive that requirement.

Use of the Term "Advisor/Adviser": Of particular interest to NAIFA, the new rules do not prohibit use of the term 'advisor/adviser" in NAIFA's name, although they do impose some new restrictions on the use of the terms "advisor/adviser" by individuals who are not registered investment advisor representatives or who work for broker-dealers who are not also registered as investment advisors.

Generally, if an individual is not an investment advisor representative, or dual-registered (as an investment advisor representative and as a registered representative of a broker-dealer), that individual may not use the term "advisor/adviser" in his/her name or title. However, if the person is dual-registered, he/she may use the term in marketing materials in describing the services he/she provides.

Impact on Compensation: The rules specifically prohibit certain types of activity and forms of compensation—e.g., sales contests or quotas tied to specific products within a limited timeframe.

Proprietary Product Sales: The new final rules require broker-dealers to design specific policies and procedures surrounding any potential conflicts of interest arising from being restricted to selling/recommending limited products options.

Impact on State Rules: The rules specifically do not preempt state rules. Rather, they leave to the courts resolution of any dispute arising from state rules that differ from the SEC rules.

Effective Date: The new rules take effect 60 days after they're published in the *Federal Register*, but the Reg BI and Form CRS rules give those impacted by the rules until June 30, 2020 to come into compliance with them.

Also included in the new rules are interpretations of the "solely incidental" guidance that outlines when a broker-dealer and its registered representatives can offer permissible advice without triggering investment advisor registration obligations. And, the rules package includes an interpretation and clarification of the fiduciary duty rules applicable to registered investment advisors.

General Reaction: Reaction to the rules was mixed. Generally, NAIFA and the financial services industry support the new best interest of the client standard, although we are still studying the voluminous rules' details—issues may arise as a result of that ongoing close study. However, consumer groups are not so happy with the SEC—many think the new rules are too lax and do not address confusion in the marketplace about the difference between a broker-dealer and a registered investment advisor. Plus, many believe the standard of care should be a full-blown fiduciary rule. There is talk about a court challenge, although no such court case has as yet been filed.

What's Next: NAIFA (and the financial services industry generally) has been saying for literally years that the Department of Labor (DOL) should wait for the SEC to act before it resumes rulemaking on the fiduciary issue. Now that the SEC has issued final new rules, the expectation is that DOL will propose new rules for the standard of care to be imposed on financial planners working in the retirement savings space. Scuttlebutt is that a new DOL rule may emerge by late in 2019. We will, of course, keep you informed as the process plays out.

NAIFA strongly encourages all members to closely follow the rules and procedures set up by their broker-dealers/investment advisor firms.

Tri-Departments Finalize New HRA Rule

The Departments of Treasury, Labor, and Health and Human Services issued a final rule that will expand the use of health reimbursement arrangements (HRAs) and could encourage employers to offer workers access to health insurance brokers, and private health insurance exchange programs.

Under the rule, two new types of HRAs are created – the individual coverage HRA and the excepted benefit HRA.

Employers will be able to use individual coverage HRAs to provide their workers with tax-preferred funds to pay for the cost of health insurance coverage that workers purchase in the individual market, subject to certain conditions.

The excepted benefit HRA will permit employers that offer traditional group health plans to provide up to $1,800 per year (indexed to inflation after 2020), to help employees pay for certain qualified medical expenses, including premiums for vision, dental, and short-term, limited-duration insurance, even if the employee doesn't enroll in the traditional group health plan.

Absent from the rule are provisions on how this new structure interacts with the employer mandate or Code section 105(h)'s nondiscrimination prohibitions relating to highly compensated individuals. The Departments have specifically reserved those topics for a separate future rulemaking.

A more detailed discussion of the rule's provisions is contained the Final Rule to Expand Access to Health Reimbursement Arrangements memo.

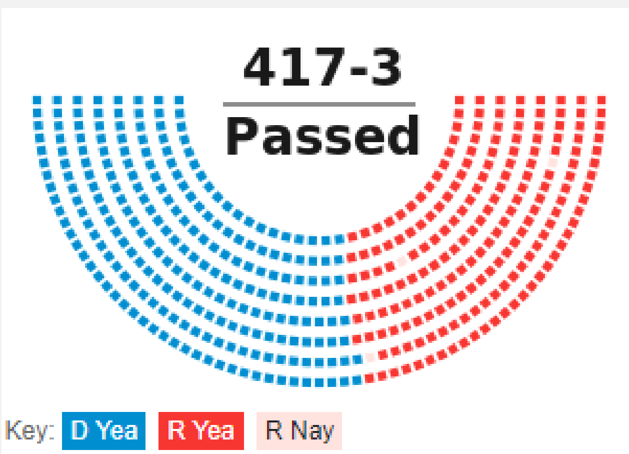
What's next: The Departments are preparing to publish the regulations in the Federal Register on June 20. Court challenges and Congressional opponents could keep the regulations from taking effect. If the regulations take effect, they will apply starting with the 2020 plan year.

Additional Resources:
FAQ

Model Notice

Model Attestation

House Passes SECURE Act



On May 23, the House of Representatives, by an overwhelming 417 to 3 vote, approved H.R.1994, the SECURE Act. The SECURE Act is a NAIFA-supported retirement savings bill that contains some two dozen provisions aimed at encouraging more retirement savings plan sponsorship and participation, especially among small businesses and their employees.

The SECURE Act would, among other things, expand eligibility for and access to multiple employer plans (MEPs); require employers to illustrate annually (using Department of Labor (DOL)-established assumptions) the amount of lifetime income, payable monthly, a plan participant could expect from his/her current account balance; ease portability of lifetime income (annuity) benefits from a plan that ceases to offer a lifetime income option; streamline discrimination rules; change the age at which required minimum distribution (RMD) rules are required from 70 ½ to 72; and eliminate the current law age restriction (age 70) after which people can no longer contribute to traditional IRAs.

The bill also contains an offset provision, the "stretch IRA rule," that is of concern. Under the rule, if it is enacted, those who inherit IRAs or 401(k) money would have to take distribution of that inherited money within 10 years of inheriting. The provision includes exceptions to that 10-year stretch rule—excepted from the rule would be surviving spouses, heirs who are disabled or

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chronically ill, minor children who inherit, and heirs who are within 10 years of the age of the decedent.

Immediately after the House passed SECURE, the Senate “hotlined” it. Hotlining is asking for unanimous consent (UC) to approve a bill, usually by a voice vote and without debate. Unfortunately for those supporting H.R.1994, the bill did not clear the hotline. A handful of Senators, all in the GOP, either objected or expressed concern. Currently, both Senate supporters of the bill and the retirement savings community—including NAIFA—are working on resolving those concerns so that the Senate can pass the bill.

The concerns identified so far range from the substantive (SECURE’s funding rules for community newspapers, its provision prohibiting use of credit cards for plan loans, and the details of the Gold Star family tax provision tucked into the bill) to procedural (the House’s last-minute drop of expanded section 529 education account rules) to political (some Senators want a floor debate on the bill, and a chance to offer amendments to it).

Key Senate supporters—including Finance Committee Chairman Sen. Charles Grassley (R-IA)—are working with the Senators who are not yet comfortable with a simple UC voice vote approval of the SECURE Act. NAIFA and its allies in the retirement savings community are also weighing in, pointing out that imperfect though the SECURE Act may be, it is a very good bill that will encourage more retirement savings. And, because of other priorities they point out that there appears to be no chance of getting enough floor time to debate/amend SECURE. Thus, key Senate personnel are saying, it is “pass SECURE or nothing.” So, the current message is to keep the perfect from being the enemy of the good, and pass the SECURE Act as it was passed by the House.

Twenty-two organizations signed a joint trades letter delivered to every Senate office urging support on June 17.

Prospects: Most Senate insiders are somewhere between hopeful and confident that at the end of the day the Senate will pass the SECURE Act—probably, they say, in the next two to three weeks. However, there are some who are more skeptical about chances for resolving all Senators’ concerns. Under the UC rules, even one Senator can stop enactment of the bill. And chances are dim for getting floor time for what could be extended debate on the SECURE Act. (It is virtually certain that quite a lot of amendments—some related to retirement savings and others not—would be offered, unless leadership could get an agreement in advance to limit debate. That, currently, looks unlikely.)

House Financial Services Committee Approves NFIP Reauthorization

On June 12, the House Financial Services Committee approved H.R. 3167, the National Flood Insurance Program Reauthorization Act of 2019, by a bipartisan vote of 59-0. The bill comes on the heels of a temporary reauthorization until September 30, 2019, that was signed by President Trump earlier this month.

The bill reauthorizes the NFIP until Sept. 30, 2024 and allows for a retroactive effective date in the event of a lapse. After a series of temporary reauthorizations to keep the fund operational, this move signals a concerted effort by both Democrats and Republicans to usher in a more permanent funding deal while reforming key components of the financially beleaguered program.

The bill includes a “continuous coverage” provision that would allow borrowers leaving the program to purchase private flood insurance to eventually return to the NFIP without penalty. It also authorizes the government to offer umbrella policies for commercial properties, including multifamily and agricultural properties and requires the Federal Emergency Management Agency to make NFIP coverage available to co-op and condo owners.

The bill would further expand flood mapping to all areas of the country while requiring FEMA to utilize updated mapping technology and adequately identify future flood risk, as well as providing $500 million for each year over five years for flood mapping. The language included would also authorize monthly payments instead of the current annual payment for flood insurance premiums.

Prospects: The bill will now be sent to the full House for consideration. After a unanimous vote across party lines within the Financial Services Committee, the outlook for full passage is positive. Party leaders on both sides of the isle have been eyeing a longer-term solution to NFIP reauthorization, with this bill looking to achieve that goal. The Senate could still pose a procedural problem if passage in the House is achieved.