

JULY 8, 2020 | PUBLICATION

SEC Regulation Best Interest

SEC Regulation Best Interest (“Reg BI”) is an expansive regulatory update that FINRA put into effect on June 30, 2020, and which directly affects most financial advisors (“FAs”) who service retail investors. Reg BI sets new and heightened conduct standards for FINRA broker-dealers and associated persons. As a result of the implementation of Reg BI, FAs will need to adhere to an entirely new set of guidelines and restrictions aimed at minimizing the chances of a breach of fiduciary duty owed to retail customers. This new regulation narrows the gap between the duties owed by a broker-dealer and FAs, but leaves considerable grey area as to its interpretation. Also included in the new Reg BI requirement is a “Form CRS” notice to customers.

SERVICE LINE

Corporate, Tax & Transactions
Data Breach Response Team
Litigation & Disputes

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REG BI SUMMARY

According to the SEC and FINRA, the focus for compliance with Reg BI will evaluate:

- 1) whether firms have established policies and procedures designed to comply with Reg BI,
- 2) whether firms have made progress in implementing the policies and procedures,
- 3) whether the policies and procedures are effective.

The **four** primary obligations under Reg BI are:

- **The Disclosure Obligation:** This requires the firm to provide the following information to retail customers in writing:
 - (A) All material facts relating to the scope and terms of the relationship with the retail customer; and
 - (B) All facts relating to conflicts of interest that are associated with the investment recommendation.
- **The Care Obligation:** This obligation requires that the firm:

(A) Understand the potential risks, rewards, and costs associated with the investment recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;

(B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the recommendation does not place the financial interest of the firm ahead of the interest of the customer; and

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial interest of the firm ahead of the interest of the customer.

- **Conflict of Interest Obligations:** This obligation requires that the firm establish and enforce written policies and procedures designed to:

(A) Identify and at a minimum disclose all conflicts of interest associated with investment recommendations;

(B) Identify and mitigate any conflicts of interest associated with recommendations that create an incentive for FAs to place the interest of the FA or firm ahead of the interest of the customer;

(C)

(1) Identify and disclose any limitations placed on the securities or investment strategies involving any conflicts of interest associated with such limitations; and

(2) Prevent such limitations and conflicts of interest from causing the FA or firm to make recommendations that place the interest of FA or firm ahead of the interest of the customer; and

(D) Identify and eliminate any sales contests, quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities.

- **Compliance Obligation:** This obligation requires that the firm establish and enforce written policies and procedures designed to achieve compliance with Reg BI.

HOW THE BROKER-DEALER LITIGATION TEAM AT SHUMAKER CAN HELP

Our expansive and experienced team of broker-dealer litigators can help your firm through the implementation phase of Reg BI. We can help you navigate all of the Obligations outlined above.

We can also assist you with:

- Developing the new Reg BI Client Relationship Summary ("Form CRS") for retail investors;
- Navigating additional compliance requirements for Firms and FAs;
- Understanding new SEC guidance concerning the "Solely Incidental" registration exemption of the Investment Advisers Act;
- Impact and readiness assessments;
- Conflicts of interest assessments;
- Product shelf reviews;
- Drafting new policies and procedures; and
- Training for compliance and sales professionals.