

Reg BI Compliance Countdown: T-Minus Six Months

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As the June 30, 2020, compliance date approaches, broker-dealers are taking steps to implement Regulation Best Interest (Reg BI), which establishes a new standard of conduct when making recommendations to retail customers of any securities transaction or investment strategy involving securities. The new rule requires additional disclosures, policies and procedures, conflict identification, and training beyond what broker-dealers have previously had in place.

Reg BI compliance steps specifically include: identifying potential conflicts of interest; assessing reasonably available alternative recommendations; reviewing, revising, and adding conflict disclosure; drafting a relationship summary (on new Form CRS); amending and developing supervisory procedures to identify and address conflicts of interest; and training associated persons to assure that each recommendation they make is in a retail customer's best interest.

The SEC and FINRA each have issued online guidance to assist broker-dealers in implementing their Reg BI compliance obligations. The regulators appear to be working together to avoid duplication and achieve consistency in guidance.

Guidance From the SEC

The SEC staff, for example, issued "Frequently Asked Questions on Form CRS" clarifying that each broker-dealer and investment adviser is to prepare only one relationship summary of "all of the principal relationships and services it offers" to retail investors no matter how many different services are offered to retail investors. The SEC staff FAQ on Form CRS also clarify relationship summary delivery scenarios. Another resource available on the SEC's website is a publication titled "A Small Entity Compliance Guide" that addresses Reg BI obligations, concepts, and terms of art.

Subsequently, the SEC staff has issued "Frequently Asked Questions on Regulation Best Interest." This document is divided into four sections, each of which provides additional guidance on an important aspect of the regulation:

- The concept of a “recommendation”
- The disclosure obligation
- The care obligation that is part of the standard of conduct
- The conflict of interest obligation

In order to assist firms with planning for compliance with the new rules, the SEC also has established an inter-Divisional Standards of Conduct Implementation Committee, and the SEC encourages firms to actively engage with this committee as questions arise in planning for implementation. Firms can send their questions by email to IABDQuestions@sec.gov.

In addition, the SEC staff has announced that, prior to the June 30 compliance date, it will engage with broker-dealers during examinations on their progress in implementing the new rules and questions they may have regarding the new rules. Again, however, the staff has characterized this pre-June 30 engagement with broker-dealers as being to “further assist” firms, rather than to find fault with them.

Guidance From FINRA

For its part, FINRA published a “Reg BI and Form CRS Firm Checklist” that sets forth 20 multipart steps to achieve Reg BI compliance and eight multipart steps to achieve Form CRS compliance as prescribed in the SEC adopting releases. FINRA’s checklist identifies key differences between current FINRA rules and SEC Reg BI and Form CRS. FINRA also has established a Reg BI webpage containing various compliance resources.

Finally, in its January 9 “Risk Monitoring and Examination Priorities Letter,” FINRA noted that, in the first part of 2020, it will review firms’ preparedness for Reg BI to understand implementation challenges. After the June 30 compliance date, FINRA intends to examine firms’ compliance with Reg BI, Form CRS, and related SEC guidance. In this regard, FINRA announced in the 2020 priorities letter that it may take into consideration the following factors when reviewing a firm for Reg BI compliance:

- Does a firm have procedures and training in place to assess recommendations using a best interest standard?
- Does a firm and its associated persons apply a best interest standard to recommendations of types of accounts?
- If a firm and its associated persons agree to provide account monitoring, do they apply the best interest standard to both explicit and implicit hold recommendations?

- Does a firm and its associated persons consider the express new elements of care, skill, and costs when making recommendations to retail customers?
- Does a firm and its associated persons consider reasonably available alternatives to the recommendation?
- Does a firm and its registered representatives guard against excessive trading, irrespective of whether the broker-dealer or associated person “controls” the account?
- Does a firm have policies and procedures to provide the disclosures required by Reg BI?
- Does a firm have policies and procedures to identify and address conflicts of interest?
- Does a firm have policies and procedures in place regarding the filing, updating, and delivery of Form CRS?

By attending as soon as possible to the numerous and complex preparations required for blastoff, broker-dealers can greatly reduce the possibility of fizzling out on the launch pad when the clock hits zero.

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