

Reg BI Cooking Instructions: Based on SEC/FINRA Exams

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FINRA intends to conduct 1,000 Regulation Best Interest (Reg BI) examinations — covering almost one-third of FINRA member firms — by year-end.

For broker-dealers distributing and selling variable annuities, examinations will test for compliance with Reg BI and FINRA Rule 2330 because both standards apply to variable annuity sales. Firms distributing and selling variable annuities may benefit from following regulators' cooking instructions to prepare for these examinations and enhance Reg BI procedures. Both the SEC and FINRA have been sending firms' compliance practices back to the kitchen for further attention.

For its part, the SEC Division of Examinations issued a risk alert on January 30, 2023, in which it highlights what it considered to be deficiencies and weak practices noted during Reg BI examinations. These related to broker-dealers' practices in connection with each component obligation of Reg BI, as follows:

- Compliance Obligation – not having adequate written policies and procedures, including instances of generic written policies and procedures that were not tailored to the firm's business model.
- Care Obligation – directing financial professionals to consider reasonably available alternatives to recommendations, or costs, without providing any guidance on how to do so.
- Conflict of Interest Obligation – identifying only those conflicts associated with prohibited activities (e.g., churning), rather than identifying all conflicts; or using high-level, generic language (e.g., “we have conflicts related to compensation differences”) that did not describe the conflicts with enough specificity.
- Disclosure Obligation – not providing disclosures to retail customers in writing but instead posting Reg BI disclosures only on the broker-dealers' websites or merely referencing the disclosures in other documents delivered to customers.

Meanwhile, FINRA outlined several variable annuity sales practices that it found problematic under Reg BI in its 2023 Report on Examination and Risk Monitoring Program, issued on January 10, 2023, including:

- Key Information – not adequately collecting and retaining key information on variable annuity transactions, particularly in connection with recommended exchanges into new variable annuity contracts.
- Training – not sufficiently training registered representatives and supervisors on how to assess and compare costs and fees, surrender charges, and long-term income riders.
- Exchanges – not reasonably supervising recommendations of exchanges into new variable annuity contracts.
- Insurer Buyout Offers – not reasonably supervising recommendations related to issuer offers to “buy out” variable annuity contracts from existing holders.
- Additional Premium Payments – not evaluating and supervising registered representatives’ recommendations of additional premium payments into existing variable annuity contracts, including review of disclosure, any applicable surrender fees related to the transaction, and the rationale for the addition.
- Reasonably Available Alternatives – insufficiently considering reasonably available alternatives to a recommended variable annuity purchase, surrender, or exchange.

By attending to the regulators’ guidance before the examiners call to make reservations, firms involved in variable annuity sales or distribution can reduce the likelihood that the examiners might get indigestion.

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