

April 10, 2020

Risk&Reward
fiduciarygovernanceblog.com
@FidGovGroup

SEC Staff Previews Regulation Best Interest Examinations



The Security and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) issued on April 7, 2020, a [Risk Alert](#) providing broker-dealers with information about the scope and content of initial examinations for compliance with Regulation Best Interest after June 30, 2020, the compliance date. The Risk Alert states that these initial examinations, which will likely occur during the first year after the compliance date, will focus on assessing whether firms have made a good faith effort to implement policies and procedures reasonably designed to comply with Regulation Best Interest, including the operational effectiveness of broker-dealers' policies and procedures. Examples of areas the staff may focus on and the types of documents that may be requested are discussed below.

Disclosure Obligation — The staff may assess how a firm has met the Disclosure Obligation's requirement to disclose material facts relating to the scope and terms of the relationship, including: (i) the capacity in which the recommendation is being made, (ii) material fees and costs that apply to the retail customer's transactions, holdings, and accounts, and (iii) material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer. In assessing compliance with this obligation, it may request the following documents, among others:

- Schedules of fees and charges assessed against retail customers and disclosures regarding such fees and charges, including disclosures regarding the fees and costs related to services and investments that retail customers will pay or incur directly and indirectly (e.g., custodian fees, account maintenance fees, fees related to mutual funds and variable annuities, and other transactional fees and product level fees);

For more information, please contact:



Lawrence P. Stadulis

Co-Chair, Fiduciary Governance

202.419.8407

lstadulis@stradley.com

- The broker-dealer's compensation methods for registered personnel, including (i) compensation associated with recommendations to retail customers, (ii) sources and types of compensation (e.g., direct payments by an investor, payments by a product sponsor), and (iii) related conflicts of interest (e.g., conflicts associated with recommending proprietary products or with receiving payments for inclusion on a product menu);
- Disclosures related to monitoring of retail customers' accounts;
- Disclosures on material limitations on accounts or services recommended to retail customers; and
- Lists of proprietary products sold to retail customers.

Care Obligation — To assess compliance with this obligation, the staff may review:

- Information collected from retail customers to develop their investment profiles (including any new account forms, correspondence, and any agreements the customer has with the broker-dealer).
- The broker-dealer's process for having a reasonable basis to believe that the recommendations are in the best interest of the retail customer (which may include, for example, any process for establishing, understanding, and implementing the scope of reasonably available alternatives when making a recommendation).
 - The factors the broker-dealer considers to assess the potential risks, rewards, and costs of the recommendations in light of the retail customer's investment profile.
 - The broker-dealer's process for having a reasonable basis to believe that it does not place the financial or other interest of the broker-dealer ahead of the interest of the retail customer.
- How the broker-dealer makes recommendations related to significant investment decisions, such as rollovers and account recommendations, and how the broker-dealer has a reasonable basis to believe that such investment strategies are in a retail customer's best interest.
- How the broker-dealer makes recommendations related to more complex, risky or expensive products and how the broker-dealer has a reasonable basis to believe that such investments are in a retail customer's best interest.

Conflict of Interest Obligation — To assess compliance with this obligation, staff may review the broker-dealer's policies and procedures to assess:

- Whether and how the policies and procedures address the following, as required by Regulation Best Interest:
 - Conflicts that create an incentive for an associated person to place its interest or the interest of a broker-dealer ahead of the interest of the retail customer;
 - Conflicts associated with material limitations (e.g., a limited product menu, offering only proprietary products, or products with third-party arrangements) on the securities or investment strategies involving securities that may be recommended to a retail customer; and
 - The elimination of sales contests, sales quotas, bonuses, and non-cash compensation arrangements based on the sale of specific securities or specific types of securities within a limited period of time.
- How the policies and procedures establish a structure for identifying the conflicts that the broker-dealer or its associated person may face. In this connection, the staff may request documentation identifying all conflicts associated with the broker-dealer's recommendations.
- How the policies and procedures establish a structure to identify and assess conflicts in the broker-dealer's business as it evolves. The staff may request all policies and procedures in place during the scope period of the examination.
- How the policies and procedures provide for disclosure of conflicts and what conflicts are disclosed.
- How the policies and procedures provide for mitigation or elimination of conflicts and what conflicts are mitigated or eliminated.

Compliance Obligation — To assess compliance with this obligation, staff may review the broker-dealer's policies and procedures and evaluate any controls, remediation of noncompliance, training, and periodic review and testing included as part of those policies and procedures.

OCIE also issued a Risk Alert on Form CRS compliance, which we described on our [blog](#).