

Updates

April 17, 2020

OCIE Issues Risk Alert on Upcoming Regulation Best Interest Examinations

The U.S. Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations (OCIE) issued a risk alert (the [risk alert](#)) on April 7, 2020, regarding examinations that will focus on broker-dealers' compliance with Regulation Best Interest ([Reg BI](#)). OCIE will begin examinations around the time of Reg BI's compliance date of June 30, 2020, and will continue the examinations for approximately a year thereafter. OCIE noted that it will not delay its Reg BI examinations on account of the COVID-19 pandemic. Importantly, the risk alert details the focus of OCIE's Reg BI examinations and lists the types information and documentation that it will be seeking.

Reg BI Examinations During the COVID-19 Pandemic

The SEC [has not extended](#) the compliance date for Reg BI due to the COVID-19 pandemic. Rather, the SEC has said that it and its staff, including those in OCIE, remain fully operational during the pandemic. The risk alert states that the Reg BI examinations will proceed as planned, beginning after June 30, 2020. However, OCIE notes that it is ready to work with broker-dealers and the SEC's Division of Trading and Markets on any issues that may arise in the course of examinations and understands that COVID-19 has created challenges for broker-dealers.

Reg BI

Reg BI seeks to extend the broker-dealer standard of conduct when broker-dealers are providing investment recommendations to retail customers through two key components: (1) the standard of conduct itself (i.e., a broker-dealer providing a recommendation to a retail customer must act in the best interest of the retail customer at the time the recommendation is made); and (2) broker-dealers must establish, maintain, and enforce policies and procedures designed to ensure compliance with Reg BI.

OCIE's Initial Reg BI Examinations: A Focus on Policies and Procedures

OCIE's initial examinations will focus on assessing broker-dealers' initial compliance with the policies and procedures component of Reg BI by examining whether broker-dealers have made a good faith effort to implement policies and procedures reasonably designed to comply with Reg BI. In the risk alert, OCIE categorized the types of information it may seek to review based on the four component obligations of Reg BI: a Disclosure Obligation, a Care Obligation, a Conflict of Interest Obligation, and a Compliance Obligation.

Disclosure Obligation

Specific Disclosures: OCIE may assess how the broker-dealer has met the disclosure obligation's requirement to disclose material facts relating to the scope and terms of the relationship, including: (1) the capacity in which the recommendation is being made, (2) material fees and costs that apply to the retail customer's transactions, holdings, and accounts, and (3) material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer.

Document Requests: OCIE may request the following types of documentation:

- Schedules of fees and charges assessed against retail customers and disclosures regarding such fees and charges
- The broker-dealer's compensation methods for registered personnel
- Disclosures related to monitoring of retail customers' accounts
- Disclosures on material limitations on accounts or services recommended to retail customers
- Lists of proprietary products sold to retail customers

Care Obligation

Document Requests: OCIE may request the following types of documentation:

- Information collected from retail customers to develop their investment profiles
- The broker-dealer's process for having a reasonable basis to believe that the recommendations are in the best interest of the retail customer, including (1) 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; and (2) 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
- How the broker-dealer makes recommendations related to riskier, more complex, or more expensive products

Conflict of Interest Obligation

Document Requests: OCIE may review the broker-dealer's policies and procedures to assess the following:

- Whether the policies and procedures address issues such as: (1) 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; (2) conflicts associated with material limitations on the securities or investment strategies involving securities that may be recommended to a retail customer; and (3) the elimination of various types of conflicts
- How the policies and procedures establish a structure for identifying the conflicts that the broker-dealer or its associated person may face
- How the policies and procedures establish a structure to identify and assess conflicts in the broker-dealer's business as it evolves
- 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

Document Requests: OCIE may review the broker-dealer's policies and procedures to evaluate any controls, remediation of noncompliance, training, and periodic review and testing.

Conclusion

The risk alert highlights that a key component to Reg BI compliance is effectively tailored policies and procedures. In its initial examinations, OCIE will be reviewing broker-dealers' policies and procedures as well as accompanying documentation. These initial examinations will begin after June 30, 2020, as planned, although OCIE noted that it will work with firms in light of any circumstances caused by the COVID-19 pandemic.

Please contact experienced securities regulatory counsel with any questions about this development and how it might apply to you or your business.

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