

Despite COVID-19, SEC and FINRA Maintain Regulation BI Compliance Date

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By: [Keith Blackman](#) and [Joshua Klein](#)

Although the SEC has been granting regulatory relief in a number of areas as a result of the COVID-19 outbreak, its Office of Compliance, Inspections and Exams (OCIE) confirmed in [a recent Risk Alert](#) that Regulation Best Interest (“Regulation BI”) will go into effect on the scheduled compliance date of June 30, 2020. Following that date, the OCIE will commence examinations to assess broker-dealers’ implementation of the sweeping new retail conduct rules. Shortly after the SEC’s announcement, FINRA [issued a statement](#) confirming that it would take the same approach set forth in the SEC Risk Alert when examining broker-dealers and associated persons for compliance with Regulation BI.

Below, we summarize the additional guidance provided by OCIE in its alert.

Regulation BI

Regulation BI, adopted by the SEC on June 5, 2019, requires broker-dealers (and their associated persons) to act in the best interest of their retail customers when making a recommendation of any securities-related transaction or investment strategy. This general obligation is satisfied only if a broker-dealer complies with four component obligations:¹

- **Disclosure Obligation:** The broker-dealer must disclose material facts about the recommendation and the relationship with the customer, including specific disclosures about the capacity in which the broker is acting, fees, the type and scope of services provided, and any conflicts of interest.
- **Care Obligation:** The broker-dealer must exercise reasonable diligence, care and skill when making a recommendation to a retail customer, and consider any potential costs and risks associated with the investment in light of the customer’s investment profile.
- **Conflict of Interest Obligation:** The broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose or eliminate conflicts of interest.
- **Compliance Obligation.** Broker-dealers must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation BI as a whole.

Following a one-year transitional period, Regulation BI is scheduled to become effective on June 30, 2020, after which the OCIE will commence examinations to assess the regulation's implementation by broker-dealers. Although the SEC has recognized that the COVID-19 pandemic creates "challenges" for market participants, including broker-dealers, it decided not to extend this compliance date.

Specific Areas Subject to Examination

Disclosure Obligation. The OCIE staff may evaluate how a firm has satisfied the Disclosure Obligation's requirements, including by reviewing: (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 recommended to the customer. To assess compliance, the OCIE staff may review the content of the disclosures and other firm records, including: fee schedules and charges assessed against the retail customer, the broker-dealer's compensation methods for its personnel, disclosures related to account monitoring, disclosures on material limitations on accounts or services recommended to customers and lists of proprietary products sold to retail customers.

Care Obligation. To assess compliance, the OCIE staff may review information collected from 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 customer, how the broker-dealer makes recommendations for significant investment decisions (such as rollovers) and for more complex, risky or expensive products.

Conflict of Interest Obligation. The OCIE staff may review a broker-dealer's policies and procedures to assess how those policies and procedures address the following potential conflicts: conflicts that create an incentive for an associated person to place his or her interest or the interest of the broker-dealer ahead of the retail customer's interest, conflicts associated with material limitations on the securities or investment strategies that might be recommended to a retail customer, and conflicts related to sales contests, sales quotas, bonuses and non-cash compensation. The OCIE staff can be expected to assess if the broker-dealer has implemented policies and procedures establishing a structure for identifying the conflicts that the broker-dealer or an associated person may face. To that end, the staff may seek documentation identifying all conflicts associated with the broker-dealer's recommendations.

Compliance Obligation. To assess compliance, OCIE staff may elect to review the broker-dealer's policies and procedures and evaluate controls, remediation of noncompliance, training, and periodic review and testing included as part of those policies and procedures.

Appendix. With respect to all of these areas, OCIE's risk alert helpfully includes an appendix that provides a sample Regulation BI information and document request. Broker-dealers should examine this list carefully, since it nicely outlines the books and records that member firms are required to maintain.

Conclusion

The SEC has now confirmed that the COVID-19 pandemic will not excuse a firm's failure to comply with Regulation BI as of June 30, 2020. Bracewell attorneys are experienced with

financial regulatory issues, and are ready and available to provide further information and discuss particular circumstances.

¹ These obligations are set forth in full in Exchange Act Rule 15c-1(a)(2).