

Securities Regulation Daily Wrap Up, BROKER-DEALERS—Panelists highlight retail investor protection issues, Reg BI, (Jun. 27, 2019)

Securities Regulation Daily Wrap Up

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By [Amy Leisinger, J.D.](#)

SEC and FINRA officials and an industry leader discussed sales practices, the suitability of complex financial products for retail investors, and issues that could arise in complying with Regulation Best Interest.

At today's joint SEC and FINRA compliance outreach program for broker-dealers, panelists considered how regulators and industry participants can better protect retail investors. They stressed the importance of reasonableness in making investment recommendations, even apart from the new obligations that will apply in connection with Regulation BI. Certain complex products may not be suitable for some retail investors, the panelists explained, and broker-dealers and investment advisers may need to dig deeper into the particular circumstances of an investor to determine what may truly be individually suitable.

Retail investors. Office of Municipal Securities Deputy Director Ahmed Abonamah noted that specific issues arise when broker-dealers recommend municipal securities, given the complexity that can be involved with these securities; any potential recommended transaction should have at least a reasonable basis, he said. FINRA Chicago District Director Laura Trotz noted that FINRA looks at risks around municipal securities when conducting examinations and specifically reviews the supervision of municipal securities investments. FINRA also looks closely at trade reporting, she said, and examiners have found instances of late or inaccurate reports, which could harm retail investors.

Abonamah also highlighted last year's new rule requiring dealers to disclose additional information on retail customer confirmations for certain principal transactions, including the dealer's mark-up or mark-down from the prevailing market price. Trotz confirmed that FINRA has examined firms on this issue and found certain failures to make disclosures, some of which stemmed from supervisory issues with clearing firms and vendors.

Jeffrey Freiburger, managing director and chief compliance officer at Robert W. Baird & Co., said that, at his firm, it is important that things are done right for retail investors. Suitability with regard to taxation issues, differing fees, and potential conflicts of interest must be considered, he stressed. Employees could be serving in a political office or on school board, and disclosures may need to be made, according to Freiburger. "Transparency is a really good thing," he stated.

Kelly Shoop of the SEC's Division of Trading and Markets noted that the Commission has really focused on retail fraud in recent years, particularly with regard to rapid trading, which has the potential to eat up retail investors' returns in terms of fees. In some cases, she explained, the costs of turnover outweigh potential benefits, which could violate reasonable-basis suitability. Other suitability problems have arisen in connection with leveraged and inverse exchange-traded products, she explained; often, the issues involved a representative who did not fully understand the product being recommended, according to Shoop.

Regulation BI. Under new Regulation BI, when making a recommendation of a securities transaction or an investment strategy involving securities, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. Regulation BI includes specific obligations in the areas of disclosure, care, conflicts of interest, and compliance. The disclosure obligation holds that broker-dealers must disclose certain material facts about the relationship and recommendations, and, under the care obligation, a broker-dealer must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer. With respect to conflicts of interest, a broker-dealer must establish, maintain, and enforce

written policies and procedures reasonably designed to identify and, at a minimum, disclose or eliminate conflicts of interest. The compliance obligation of Regulation BI requires policies and procedures reasonably designed to achieve compliance with Regulation BI as a whole.

Shoop noted that the disclosure obligation is designed to embody principles of flexibility and reasonableness and that the care obligation involves a requirement to understand risk and rewards and consider alternatives. In addition, she explained, firms now must expressly consider surrender costs and increases in fees, which is a change from past suitability requirements. Daniel Gregus of the SEC's Chicago Regional Office noted that suitability will continue to apply if broker-dealers push to sell certain product types or shift accounts in advance of Regulation BI.

As firms begin to comply with Regulation BI, there could be a shift in account types, according to Freiburger. In addition, firms will need to ask more questions about what is going on in investors' lives and what circumstances may have changed. Monitoring will be different than in the past, he concluded.

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