# Securities Regulation Daily Wrap Up, TOP STORY—SEC roundtable: Firms generally meeting Reg BI obligations, but still room for improvement, (Oct. 27, 2020)

Securities Regulation Daily Wrap Up

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By Amanda Maine, J.D.

Panelists praised the efforts of firms to comply with Regulation BI during the pandemic, but outlined several areas where firms can take steps to improve their compliance.

Representatives from the SEC's Office of Compliance Examinations and Inspections (OCIE), Division of Trading and Markets (TM), Division of Investment Management (IM), as well as a representative from FINRA participated in a roundtable discussion about the staff's initial observations on the implementation of Regulation Best Interest and Form CRS. The regulation, which was adopted in June 2019, went into effect with a compliance date of June 30, 2020.

**Regulation Best Interest.** Reg BI requires that when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, a broker-dealer must act in the best interest of the retail customer at the time the recommendation is made, without placing its own financial or other interest ahead of the retail customer's interest. A risk alert issued by OCIE in April outlined four obligations of the rule that would be the focus of the initial staff examinations: the compliance obligation, the care obligation, the conflicts of interest obligation, and the disclosure obligation. The staff addressed each of these obligations and issues that have arisen during their initial examinations.

Regarding the compliance obligation, John Polise of OCIE said that the staff had found that firms generally made good faith efforts to implement written policies and procedures. However, in some instances, the policies and procedures just restate the standard and don't provide additional guidance to the firm's registered representatives. For example, the document will say that the firm provides costs and reasonably available alternatives, but they are not identified, he said. He added that some firms are using compliance tools to implement the regulation; he emphasized that such tools must be appropriate for a firm and its business model and that they are not enough by themselves to ensure compliance.

IM Assistant Chief Counsel Lourdes Gonzalez reminded firms that while the rule says that building on an existing compliance system is allowed, it is still necessary to think about how to build Reg BI into that system. While Reg BI builds on existing requirements, it casts a wider net than the suitability standard, she said.

Bill St. Louis of FINRA said firms FINRA has examined so far are generally taking good steps. He noted that firms that were actively preparing for the Department of Labor's now-vacated fiduciary rule were well-positioned to implement Reg BI. Regarding particular compliance concerns, St. Louis said that some procedures had been developed but not memorialized, some procedures lacked details on the "who, when, and how," and a lack of controls around testing the procedures or recordkeeping requirements.

The panelists were also asked about how firms are training their registered representatives to comply with Reg BI. Polise noted that many firms had planned in-person training, but the COVID-19 pandemic resulted in a lot of training being conducted online. While the staff has seen good training, it identified some weaknesses, such as focusing on the rule requirements rather than how the firm expects the reps to comply with the rule. Polise added that the staff has noticed good training on firms' proprietary compliance systems.

As for FINRA, St. Louis pointed out some positive steps firms have taken in their Reg BI training to make sure it sticks. For example, some firms require post-training tests for their reps. Other firms have fined their reps for not completing training on time. This shows that the firms are taking training seriously, St. Louis said.

Turning to the care obligation, Polise said that OCIE is looking at how firms using tools are incorporating them into their procedures, including proprietary systems for specific products. Some firms have developed up-front reviews for certain products before they go into a registered representative's portfolio to offer to customers.

St. Louis said FINRA has observed that some firms have developed questionnaires to calculate risk scores based on customer objectives. Some firms have even required their reps to input comments regarding each recommendation they make as a way to document the care analysis, he remarked. He also noted that some firms are confused about what constitutes a "recommendation." Gonzalez pointed out that Regulation BI did not change the Commission's analysis on what a recommendation is. The closer it is to a call to action and personalized to the investor, the more likely it is a recommendation, Gonzalez said.

On the conflicts of interest obligation, Polise said the staff is still finding that some firms are taking too much of a suitability approach. Don't just find and replace "suitability" with "best interest," he cautioned. St. Louis described some procedures that firms have developed regarding conflicts of interest, including annually reviewing compensation agreements, business affiliates, business relations, and associated activity for conflicts, on top of the work they have already done with their inventory of conflicts. Gonzalez highlighted several FAQs on the Commission's website that can help firms deal with complying with Reg BI's conflicts of interest obligation.

Finally, on the disclosure obligation, Polise observed that most firms rely on some combination of Form CRS and one or more Reg BI disclosure documents. He reminded firms that technical language should be avoided and to use Plain English when making disclosures.

St. Louis noted that firms have been implementing good technology solutions for delivery of Reg BI disclosures, including electronic delivery. Gonzalez added that both Reg BI and Form CRS permit electronic delivery as long as it is consistent with existing guidance. She noted that the staff is planning to revisit its existing electronic delivery guidance, but as of today, electronic delivery must be made under the current framework.

Regarding the removal of certain titles from firm names and registered representatives, St. Louis said that FINRA sent reminders to firms with the word "Adviser" in their title to remind them that brokers who are not dually registered as investment advisers cannot use the term "adviser" or "advisor" in their title. He also remarked that some firms have committed to monitor their social media and emails to make sure this restriction is being followed.

**Form CRS.** Under Regulation Best Interest, investment advisers and broker-dealers are required to deliver a relationship summary to retail investors at the beginning of their relationship that will summarize information about services, fees and costs, conflicts of interest, legal standard of conduct, and whether or not the firm and its financial professionals have disciplinary history. The panelists presented highlights of what they have observed so far from filed Forms CRS.

TM Senior Special Counsel Alicia Goldin emphasized the importance of using plain language in creating a concise document that avoids technical and legal terms. While most firms rose to the challenge of doing so, there is always room for improvement, she said. The average reading level of Form CRS was 11th grade—the staff encourages firms to aim for an eighth-grade reading level for best readability, Goldin advised.

She also praised firms' use of layered disclosure in Form CRS, noting that many relationship summaries included cross-references and hyperlinks to more detailed information such as fee disclosures. However, some did not provide this information or just mentioned it without providing a way to access the information.

IM Assistant Director Melissa Gainor said some firms made good use of white space and text headings in the relationship summary. For example, some dual registrants used side by side charts to make the information easy to digest. However, other firms' relationship summaries included dense text covering the entire document. She encouraged firms to consider using white space, tables, and bold and italic fonts to improve readability.

She also cautioned that firms should steer away from marketing language and the use of superlatives and other descriptors. Firms should make concise and factual disclosures, Gainor said, not treat Form CRS as a marketing pamphlet.

Regarding conflicts of interest, Goldin said that many firms included examples of incentives about their proprietary products, but others failed to explain them and used vague phrasing, such as the firm "may" have a conflict. She added that other firms attempted to downplay or minimize conflicts of interest.

Jim Wrona of FINRA said the biggest issue he has seen on Form CRS involves the disclosure of disciplinary history. Some firms said "no" when they should have said "yes," and others did not disclose anything regarding disciplinary history at all. Wrona reminded firms that a non-answer is not permitted here. Goldin added that some firms provided extraneous language explaining their response to the disciplinary question, which is also not permitted.

Overall, firms were generally compliant with Form CRS's requirements. Gainor recommended that firms put themselves in the shoes of retail investors when assessing the form's readability. Wrona remarked that he was impressed with firms' efforts, especially since much of it was accomplished in the midst of a pandemic.

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