

The First OCIE Inspection of Brokers Re Regulation Best Interest

Regulation Best Interest, born of a long debate over the appropriate standard to govern recommendations by broker-dealers, is now the subject of an OCIE Risk Alert. The staff is preparing to launch its first inspection for compliance with Regulation Best Interest following the June 30, 2020 required compliance date, according to Alert April 7, 2020 Alert ([here](#)). While the Commission has adjusted some obligations in view of the virus driven shelter in place orders that govern much of the country, Chairman Clayton has made it clear that the deadline for Regulation Best Interest will not be extended.

The initial Regulation Best Interest examinations will focus on whether a good faith effort has been made to implement the regulation. The assessment will be made through an evaluation of the design of the policies and procedures used by the entity to implement the regulation, reflected in part by the related materials.

The goal of Regulation Best Interest is to assure that when “making a recommendation of any securities transaction or investment strategy . . . to a retail customer a broker-dealer . . . [acts] in the best interest of the retail customer . . .” This obligation is measured by four broad points which constitute the framework of the coming OCIE inspections:

Disclosure Obligation: Prior to making a recommendation this obligation requires the disclosure of all material facts regarding the relation with the customer, including any conflicts tied to the recommendation. The disclosures should include limitations on the strategy being recommended as well as the related fees and costs. Compliance with the obligation will be assessed in part by an examination of the related documents and schedules which may include a review of the broker’s compensation associated with the recommendation, materials related to monitoring and an assessment of proprietary products sold to retail customers.

Care Obligation: This obligation requires the broker-dealer to exercise reasonable diligence, skill and care in making a recommendation. It includes discussing the

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potential risks and rewards as well as the costs. The obligation may be reflected in correspondence and any agreement with the customers as well as materials relating to the predicate for the recommendation and its reasonable basis. Other materials to be examined include those related to the manner in which the broker makes recommendations for complex and/or risky investments or securities.

Conflict of Interest Obligation: In view of this obligation the broker dealer must establish and maintain policies and procedures to address conflicts associated with its recommendations to retail customers. Key documents tied to this obligation include those which identify and relate to incentives that would cause the broker to put the interest the broker or firm before that of the client. Also included are those associated with material limitations of the securities or investment strategy. In addition, material will be examined regarding the elimination of items such as sales contests, quotas and similar matters. Other materials to be examined include those which establish the structure for identifying conflicts and those tied to mitigation and disclosure.

Compliance Obligation: This obligation requires the broker-dealer to establish and maintain written policies and procedures to achieve compliance with Regulation Best Interest. Documents related to this point include materials tied to the related controls for the policies and procedures, those relating to the promotion of compliance and the remediation of noncompliance as well as training.

Finally, the point of the Alert is to encourage compliance with the Regulation. The Alert was prepared in the interest of transparency to help achieve that goal. Attached to the Alert is a sample document request.