

A Guide to the SEC's Reg BI Bulletins

In a recent bulletin, the SEC warns that practically all financial professionals have at least some conflicts of interest with their retail investors.

By John Manganaro

This year, the staff of the Securities and Exchange Commission has published a series of [interpretive bulletins](#) providing additional compliance guidance for broker/dealers and investment advisers subject to the SEC's Regulation Best Interest and the Investment Advisers Act of 1940.

Almost two years after the rule's effective date, the SEC has also [brought the first known enforcement action](#) specifically alleging violations of Reg BI. Attorneys say the charges represent a milestone for the brokerage and advisory industries, in part because of the moment's symbolic force, but also because of what industry practitioners can take away from the situation. As Issa Hanna, a partner at Eversheds Sutherland, puts it, the enforcement action and the staff bulletins clearly demonstrate the serious compliance obligations at the heart of Reg BI.

Now, two attorneys with the Wagner Law Group, Stephen Wilkes and Seth Gaudreau, have issued their own compliance alert, in which they dissect the recent Reg BI bulletins and offer insight to advisers and brokers subject to the expansive regulation.

What Is a Conflict of Interest?

The SEC bulletin defines a "conflict of interest" under Reg BI and the fiduciary standard as any interest that might incline a broker/dealer or investment adviser—consciously or unconsciously—to make a recommendation or render advice

According to Wilkes' and Gaudreau's analysis, the SEC staff has expressed a clear view that all broker/dealers, investment advisers and financial professionals have "at least some" conflicts of interest with their relationships with retail investors. In the staff's estimation, the economic incentives for firms and financial professionals to recommend various products and services that may not be in a retail investor's best interest create substantial conflicts of interest.

"The staff also clarifies that under Reg BI not only must broker/dealers establish, maintain and enforce written policies and procedures reasonably designed to identify all conflicts of interest—they must also identify conflicts of interest on an ongoing basis," Wilkes and Gaudreau wrote.

Disclosure Alone Does Not Suffice

The attorneys' analysis posits that disclosures alone do not satisfy the obligation to act in the retail investor's best interest, and any conflicts should and must be mitigated or eliminated.

As the attorneys noted, Reg BI requires broker/dealers to have written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses and noncash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.

Under the Investment Advisers Act, the attorneys wrote, such conflicts of interest must be "fully and fairly disclosed" to allow a client to provide informed consent. If such informed consent cannot be obtained, they warned, then the conflict needs to be eliminated.

"The bulletin provides a generalized example that firms with compensation and incentive programs, based on benchmarks, quotas or other performance metrics, whose benefits are seen to influence a financial professional's decision regarding a retail investor's interests, will be scrutinized by the SEC," the Wagner attorneys explained. "The staff has concerns that the level of rewards associated

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Disclosures Aren't 'Check-the-Box'

Wilkes and Gaudreau emphasized that specific conflicts need to be disclosed in “plain English” and tailored to a firm’s business models and compensation structures—as well as to the different products offered.

“The staff warns that generalized disclosures that a conflict ‘may’ exist is not a sufficient disclosure where a conflict exists,” they wrote. “In cases where the nature and extent of the conflict make it difficult to convey the material facts or effects of the conflict, then it cannot be fully and fairly disclosed and a firm should consider mitigation or elimination of the conflict.”

The staff bulletin provides best practices and a “nonexhaustive” list of examples that need to be disclosed, the attorneys observed, highlighting the fact that addressing conflicts is not a single exercise.

“Firms need to monitor conflicts of interest over time and periodically assess the adequacy and effectiveness of their policies and procedures to ensure compliance with Reg BI and the fiduciary standard,” the attorneys concluded.

“[The SEC] further states the importance of documenting the measures a firm has taken to address and monitor conflicts of interest, in order to show that the firm and its financial professionals are not placing their interests ahead of retail investors.”

Tagged: Business model, Regulation Best Interest, Rollovers, SEC

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