Regulation Best Interest

A Small Entity Compliance Guide[1]

This compliance guide is divided into the following parts:

1. Introduction

On June 5, 2019, the Securities and Exchange Commission ("Commission") adopted Regulation Best Interest, which establishes a new standard of conduct under the Securities Exchange Act of 1934 ("Exchange Act") for broker-dealers and natural persons who are associated persons of a broker-dealer ("associated persons") (unless otherwise indicated, together referred to as "broker-dealer" or "you") when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer.

When making such a recommendation to a retail customer, you must act in the best interest of the retail customer at the time the recommendation is made, without placing your financial or other interest ahead of the retail customer's interests.

This ***general obligation*** is satisfied only if you comply with four specified ***component obligations*****:**

- ***Disclosure Obligation*****:** provide certain required disclosure before or at the time of the recommendation, about the recommendation and the relationship between you and your retail customer;
- ***Care Obligation*****:** exercise reasonable diligence, care, and skill in making the recommendation;
- ***Conflict of Interest Obligation***: establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest; and
- ***Compliance Obligation*****:** establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

Record-making and Recordkeeping: You must also comply with new record-making and recordkeeping requirements.

2. What recommendations are covered?

Regulation Best Interest applies to recommendations of any securities transaction or investment strategy involving securities (including account recommendations).

- ***What is a recommendation?*** The determination of whether a broker-dealer has made a recommendation that triggers application of Regulation Best Interest turns on the facts and circumstances of a particular situation, and therefore, whether a recommendation has been made is not susceptible to a bright line definition. Factors considered in determining whether a recommendation has taken place include whether the communication "reasonably could be viewed as a 'call to action'" and "reasonably would influence an investor to trade a particular security or group of securities." The more individually tailored the communication to a specific customer or targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a "recommendation."

  We interpret whether a recommendation has been made to a retail customer that triggers the best interest obligation consistent with precedent under the anti-fraud provisions of the federal securities laws as applied to broker-dealers and with how the term has been applied under the rules of self-regulatory organizations (such as FINRA).

  Regulation Best Interest does not apply to investment advice provided to a retail customer by a dual-registrant when acting in the capacity of an investment adviser, even if the retail customer has a brokerage relationship with the dual-registrant or the dual-registrant executes the transaction in a brokerage capacity. [2]

- ***Account recommendations*** include recommendations of securities account types generally (e.g., to open an IRA or other brokerage account), as well as recommendations to roll over or transfer assets from one type of account to another (e.g., a workplace retirement plan account to an IRA). As discussed more below, special considerations exist where the financial professional making the recommendation is dually-registered.
- ***Any securities transaction or investment strategy involving securities*** **includes:**
  - explicit hold recommendations; and
  - implicit hold recommendations that are the result of agreed-upon account monitoring between the broker-dealer and retail customer. Special considerations for providing agreed-upon account monitoring are discussed more below.

When making an account type recommendation, does Regulation Best Interest or the Advisers Act apply?

Dually registered financial professionals: If you are a financial professional who is dually registered (i.e., an associated person of a broker-dealer and a supervised person of an investment adviser (regardless of whether you work for a dual-registrant, affiliated firm, or unaffiliated firm)) making an account recommendation to a retail customer, whether Regulation Best Interest or the Advisers Act applies will depend on the capacity in which you are acting when making the recommendation. If you are acting as a broker-dealer or associated person thereof, you must comply with Regulation Best Interest and will need to take into consideration all types of accounts that you offer (i.e., both brokerage and advisory accounts) when making the recommendation of an account that is in the retail customer's best interest.

Individuals registered only as broker-dealers or associated persons: If you are only registered as an associated person of a broker-dealer (regardless of whether that broker-dealer entity is a dual-registrant or affiliated with an investment adviser), Regulation Best Interest will apply to that account recommendation, but you

need to take into consideration only the brokerage accounts available. You can only recommend a brokerage account that the broker-dealer offers if you have a reasonable basis to believe that the recommended brokerage account is in the best interest of the retail customer, and the broker-dealer otherwise complies with Regulation Best Interest.

Special considerations for agreed-upon account monitoring

You may agree with a retail customer to take on additional obligations beyond those imposed by Regulation Best Interest. For example, you may agree with a retail customer to provide monitoring of your retail customer's investments on a periodic basis for purposes of recommending changes in investments.

When you agree with a retail customer to monitor that customer's account: (1) you are required to disclose the terms of such account monitoring services (including the scope and frequency of such services) pursuant to the Disclosure Obligation; and (2) such agreed-upon monitoring involves an implicit recommendation to hold (i.e., recommendation not to buy, sell, or exchange assets pursuant to that securities account review) at the time the agreed-upon monitoring occurs.

Scope of monitoring: Regulation Best Interest does not impose a duty to monitor a retail customer's account. In addition, it does not change the scope of account monitoring that you may agree to provide.

Regulation Best Interest also does not change the scope of activities that would come within the "solely incidental" prong of the broker-dealer exclusion to the definition of "investment adviser" in the Advisers Act.[3] You may choose to adopt policies and procedures that, if followed, would help demonstrate that any agreed-upon monitoring is in connection with and reasonably related to your primary business of effecting securities transactions.

Agreed-upon monitoring: If you agree with a retail customer to perform account monitoring services, you are taking on an obligation to review and make recommendations with respect to that account (e.g., to buy, sell or hold) on the specified, periodic basis that you have agreed to with the retail customer. For example, if you agree to monitor your retail customer's account on a quarterly basis, the quarterly review and each resulting recommendation to purchase, sell, or hold will be a recommendation subject to Regulation Best Interest.

Implicit hold recommendations: If you have agreed to perform account monitoring services, then Regulation Best Interest applies even where you remain silent (i.e., an implicit hold recommendation).

Voluntary account review: You may voluntarily, and without any agreement with your customer, review the holdings in your retail customer's account for the purposes of determining whether to provide a recommendation to the customer. This voluntary review is not considered to be "account monitoring," nor would it in itself create an implied agreement with the retail customer to monitor the customer's account.

Any explicit recommendation made to your retail customer as a result of any such voluntary review would be subject to Regulation Best Interest.

3. Who is a Retail Customer?

Retail customer: A "retail customer" is a natural person, or the legal representative of such person, who:

- receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and
- uses the recommendation primarily for personal, family, or household purposes.

Legal representative: A "legal representative" of such person includes the non-professional legal representatives of such a natural person, for example, a non-professional trustee that represents the assets of a natural person.

Uses: We interpret that a retail customer "uses" a recommendation of a securities transaction or investment strategy involving securities when, as a result of the recommendation:

- the retail customer opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation;
- the retail customer has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation; or
- the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation, even if that retail customer does not have an account at the broker-dealer.

***Personal, family, or household purposes*:** A retail customer who uses the recommendation primarily for "personal, family or household purposes" means *any* recommendation to a natural person for his or her account would be subject to Regulation Best Interest, other than recommendations to natural persons seeking these services for commercial or business purposes.

4. What does the Disclosure Obligation require?

You must, prior to or at the time of the recommendation, provide the retail customer, in writing, full and fair disclosure of:

- all material facts relating to the ***scope and terms of the relationship with the retail customer***; and
- all material facts relating to ***conflicts of interest that are associated with the recommendation***.

What are the material facts relating to the scope and terms of the relationship with the retail customer that must be disclosed?

- Material facts relating to the ***scope and terms of the relationship*** with the retail customer include:
    - that the broker, dealer, or such natural person is acting as a broker, dealer, or an associated person of a broker-dealer with respect to the recommendation;
    - ***material fees and costs*** that apply to the retail customer's ***transactions, holdings, and accounts***; and
    - the ***type and scope of the services*** to be provided to the retail customer, ***including any material limitations*** on the securities or investment strategies that may be recommended to the retail customer.
- Other material facts relating to the ***type and scope of services*** provided to the retail customer, and that must be disclosed, include:
    - whether or not you will ***monitor*** the retail customer's account and the ***scope and frequency*** of any account monitoring services that you agree to provide; and
    - whether you have any ***requirements*** for retail customers to open or maintain an account or establish a relationship, such as a minimum account size.
- Other material facts relating to the ***scope and terms of the relationship*** with the retail customer that must be disclosed include:
    - ***general basis*** for your recommendations (i.e., what might commonly be described as your investment approach, philosophy, or strategy); and
    - ***risks*** associated with your recommendations in standardized terms.
- Additionally, you must consider, based on the facts and circumstances, whether there are other material facts relating to the scope and terms of the relationship with the retail customer that need to be disclosed.

What are the material facts relating to conflicts of interest associated with a recommendation that must be disclosed?

For purposes of Regulation Best Interest a ***"conflict of interest"*** is defined to mean "an interest that might incline a broker, dealer, or a natural person who is an associated person of a broker or dealer – consciously or unconsciously – to make a recommendation that is not disinterested."

- Such conflicts include, for example: conflicts associated with proprietary products, payments from third parties, and compensation arrangements.
- Broker-dealers must disclose all ***material facts*** relating to conflicts of interest associated with the recommendation.

For purposes of Regulation Best Interest, "material facts" is interpreted consistent with the standard articulated in *Basic v. Levinson*.[4] Accordingly, information is material if there is a "substantial likelihood that a reasonable shareholder would consider it important." In the context of Regulation Best Interest, the standard is the retail customer, as defined in the rule.

What is "full and fair" disclosure?

The Release contains guidance on what constitutes *"*full and fair*"* disclosure under Regulation Best Interest. Your obligation to provide full and fair disclosure should give sufficient information to enable a retail investor to make an informed decision with regard to the recommendation.

What fees and costs must be disclosed?

The Release contains guidance on what fees and costs must be disclosed. The Disclosure Obligation requires disclosure of material fees and costs relating to a retail customer's transactions, holding, and accounts. This obligation would not require individualized disclosure for each retail customer. Rather, the use of standardized numerical or other non-individualized disclosure (e.g., reasonable dollar or percentage ranges) is permissible.

Fees and costs are material and must be disclosed if there is a "substantial likelihood that a reasonable shareholder would consider it important."

We would generally expect that, to satisfy the Disclosure Obligation, you would build upon the material fees and costs identified in the Form CRS (Relationship Summary), providing additional detail as appropriate.

Do all disclosures need to be in writing, and before or at the time of the recommendation?

Oral Disclosures: Although the disclosures necessary to satisfy the Disclosure Obligation must be in writing, in certain circumstances, you may satisfy your Disclosure Obligation by making supplemental oral disclosure not later than the time of the recommendation, provided that you maintain a record of the fact that oral disclosure was provided to the retail customer.

Disclosure After the Recommendation: In addition, in the limited instances where existing regulations permit disclosure after the recommendation is made (e.g., trade confirmation, prospectus delivery), you may satisfy your Disclosure Obligation regarding the information contained in the applicable disclosure document by providing such document to your retail customer after the recommendation is made.

Initial written disclosure: Before supplementing, clarifying or updating written disclosures in the limited circumstances described above, you must provide an initial disclosure in writing that identifies the material fact and describes the process through which such fact may be supplemented, clarified or updated. For example:

- **Product-level fees:** With regard to product-level fees, you could provide an initial standardized disclosure of product-level fees generally (e.g., reasonable dollar or percentage ranges), noting that further specifics for particular products appear in the product prospectus, which will be delivered after a transaction in accordance with the delivery method the retail customer has selected, such as by mail or electronically.
- **Capacity**: Similarly, with regard to the disclosure of a broker-dealer's capacity, a dual-registrant could disclose that recommendations will be made in a broker-dealer capacity unless otherwise expressly stated at the time of the recommendation, and that any such statement will be made orally.

- **Associated Person Conflicts of Interest**: A broker-dealer could disclose that its associated persons may have conflicts of interest beyond than those disclosed by the broker-dealer, and that associated persons will disclose, where appropriate, any additional material conflicts of interest not later than the time of a recommendation, and that any such disclosure will be made orally.

Can the Disclosure Obligation be satisfied through Form CRS (Relationship Summary) or other disclosures?

Although you may use a Relationship Summary and other standardized disclosures about your products and services to help satisfy the Disclosure Obligation, these disclosures may not be sufficient to satisfy the Disclosure Obligation.

Whether the Relationship Summary standing alone, or any additional or existing disclosures, satisfy any of these required disclosures in full would depend on the facts and circumstances.

In most instances, you will need to provide additional information beyond that contained in the Relationship Summary in order to satisfy the Disclosure Obligation.

Am I prohibited from using the term "advisor" or "adviser"?

The Commission presumes that the use of the terms "adviser" and "advisor" in a name or title by (i) a broker-dealer that is not also registered as an investment adviser or (ii) an associated person that is not also a supervised person of an investment adviser to be a violation of the capacity disclosure requirement under Regulation Best Interest.

5. What does the Care Obligation require?

Under the Care Obligation, you must exercise **reasonable diligence, care, and skill** when making a recommendation to a retail customer to:

- understand potential risks, rewards, and costs associated with recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers**;**
- have a reasonable basis to believe the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the interest of the broker-dealer ahead of the interest of the retail customer; and
- have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile.

Whether you have complied with the Care Obligation will be evaluated as of the time of the recommendation (and not in hindsight).

What does the first component of the Care Obligation require?

You must exercise reasonable diligence, care, and skill to understand the potential risks, rewards, and costs associated with the recommendation.

What would constitute reasonable diligence, care, and skill will vary depending on, among other things, the complexity of and risks associated with the recommended security or investment strategy and the broker-dealer's familiarity with the recommended security or investment strategy.

While every inquiry will be specific to the particular broker-dealer and the recommended security or investment strategy, you generally should consider ***important factors*** such as:

- the security's or investment strategy's:

    - investment objectives;
    - characteristics (including any special or unusual features);
    - liquidity;
    - volatility; and
    - likely performance in a variety of market and economic conditions;
- the expected return of the security or investment strategy; and
- any financial incentives to recommend the security or investment strategy.

Together, this inquiry should allow you to develop a sufficient understanding of the security or investment strategy and to be able to reasonably believe that it could be in the best interest of at least some retail customers.

What does the second component of the Care Obligation require?

You must consider the risks, rewards, and costs in light of the retail customer's investment profile and have a reasonable basis to believe that the recommendation is in that particular customer's best interest and does not place the broker-dealer's interest ahead of the customer's interest.

The ***retail customer's investment profile*** is defined to include, but is not limited to the retail customer's:

- age;
- other investments;
- financial situation and needs;
- tax status;
- investment objectives;
- investment experience;
- investment time horizon;
- liquidity needs;
- risk tolerance; and
- any other information the retail customer may disclose to the broker in connection with a recommendation

What does the third component of the Care Obligation require?

When recommending a series of transactions, you must have a reasonable basis to believe that the transactions taken together are not excessive, even if each is in your customer's best interest when viewed in isolation. The requirement applies irrespective of whether you exercise actual or *de facto* control over a customer's account.

What would constitute a "series" of recommended transactions would depend on the facts and circumstances, and would need to be evaluated with respect to a particular retail customer.

Does a broker-dealer need to consider every possible alternative when making a recommendation?

You should consider reasonably available alternatives, if any, offered by your broker-dealer in determining whether you have a reasonable basis for making the recommendation.

This exercise would require you to conduct a review of such reasonably available alternatives that is reasonable under the circumstances, which will depend on the facts and circumstances at the time of the recommendation.

Are there specific factors a broker-dealer should consider when making account type recommendations, or recommendations to open an IRA, or to roll over assets into an IRA?

- With respect to ***account type recommendations***, you should generally consider:
    - the services and products provided in the account;
    - the projected cost to the retail customer of the account;
    - alternative account types available;
    - the services requested by the retail customer; and
    - the retail customer's investment profile.
- When making ***recommendations to open an IRA, or to roll over assets into an IRA***, you should consider a variety of factors including, but not limited to:
    - fees and expenses;
    - level of services available;
    - available investment options;
    - ability to take penalty-free withdrawals;
    - application of required minimum distributions;
    - protections from creditors and legal judgments;
    - holdings of employer stock; and
    - any special features of the existing account.

Are there special considerations when broker-dealers recommend securities or investment strategies that are complex or risky?

When recommending securities or investment strategies that are complex, such as inverse or leveraged exchange-traded products, you should take particular care to make sure you understand the terms, features, and risks – as with the potential risks, rewards, and costs of any security or investment strategy – in order to establish a reasonable basis to recommend the product to retail customers. Further, you must weigh the potential risks, rewards, and costs of the particular product or investment strategy, in light of the particular retail customer's investment profile.

Thus, when recommending such products, you should understand that inverse and leveraged exchange-traded products that are reset daily may not be in the best interest of retail customers who plan to hold them for longer than one trading session, particularly in volatile markets. Further, these products may not be in the best interest of a retail customer absent an identified, short-term, customer-specific trading objective.

Similarly, when recommending potentially-high risk products, such as penny stocks or other thinly-traded securities, you should generally apply heightened scrutiny to whether such investments are in your retail customer's best interest.

Is a broker-dealer required to recommend the lowest-cost security or investment strategy?

While you must understand and consider costs when making a recommendation, it is only one important factor among many factors. Thus, you would not satisfy the Care Obligation by simply recommending the least expensive or least remunerative security without any further analysis of the other factors and the retail customer's investment profile.

For example, depending on the facts and circumstances, you may be able to recommend a more expensive security or investment strategy if there are other factors about the product or strategy that reasonably allow you to believe it is in the best interest of your retail customer, based on that retail customer's investment profile.

6. What does the Conflict of Interest Obligation require?

The Conflict of Interest Obligation (and the Compliance Obligation discussed below), applies solely to the broker-dealer entity, and not to the associated persons of a broker-dealer. For purposes of discussing the Conflict of Interest Obligation, the term “broker-dealer” or “you” refers only to the broker-dealer entity, and not to such individuals.

Under the Conflict of Interest Obligation, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest associated with its recommendations to retail customers.

Specifically, the ***written policies and procedures*** must be reasonably designed to:

- ***Identify and at a minimum disclose, pursuant to the Disclosure Obligation, or eliminate all conflicts of interest associated with such recommendations***;
- ***Identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for the broker-dealer’s associated persons*** to place their interest or the interest of the broker-dealer ahead of the retail customer’s interest;
- ***Identify and disclose*** any ***material limitations***, such as ***a limited product menu*** or ***offering only proprietary products***, placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, and prevent such limitations and associated conflicts of interest from causing the broker-dealer or the associated person to place the interest of the broker-dealer or the associated person ahead of the retail customer’s interest; and
- ***Identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time***.

How should you develop policies and procedures to mitigate certain incentives to associated persons?

Your policies and procedures must be reasonably designed to reduce the potential effect such conflicts may have on a recommendation given to a retail customer.

You have flexibility to develop and tailor reasonably designed policies and procedures that include conflict mitigation measures, based on your circumstances, such as your size, retail customer base (for example, the diversity of investment experience and financial needs), and the complexity of the security or investment strategy involving securities that is being recommended, some of which may be weighed more heavily than others.

Policies and procedures may be reasonably designed at the outset, but may later cease to be reasonably designed based on subsequent events or information obtained, for example, through supervision (e.g., exception testing) of associated person recommendations. Your actual experience should be used to revise your measures as appropriate.

Do different incentives require different mitigation measures?

There are a number of different kinds of incentives and, depending on the specific characteristics of an incentive, different levels and types of mitigation measures may be necessary.

For example, incentives tied to asset accumulation generally would present a different risk and require a different level or kind of mitigation, than variable compensation for similar securities, which in turn may present a different level or kind of risk and may require different mitigation methods than differential or variable compensation or financial incentives tied to broker-dealer revenues.

In certain instances, compliance with existing supervisory requirements and disclosure may be sufficient, for example, where a broker-dealer may develop a surveillance program to monitor sales activity near compensation

thresholds.

What are some potential mitigation measures?

The following ***non-exhaustive list of practices could be used as potential mitigation methods*** for broker-dealers to comply with the mitigation requirement:

- avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- minimizing compensation incentives for employees to favor one type of account over another; or to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis, for example, by establishing differential compensation based on neutral factors;
- eliminating compensation incentives within comparable product lines by, for example, capping the credit that an associated person may receive across mutual funds or other comparable products across providers;
- implementing supervisory procedures to monitor recommendations that are:
    - near compensation thresholds;
    - near thresholds for broker-dealer recognition;
    - involve higher compensating products, proprietary products or transactions in a principal capacity; or,
    - involve the roll over or transfer of assets from one type of account to another (such as recommendations to roll over or transfer assets in an ERISA account to an IRA) or from one product class to another;
- adjusting compensation for associated persons who fail to adequately manage conflicts of interest; and
- limiting the types of retail customer to whom a product, transaction or strategy may be recommended.

What are “material limitations” on recommendations?

A “material limitation” placed on the securities or investment strategies involving securities that may be recommended would include, for example, recommending only:

- proprietary products, that is, any product that is managed, issued, or sponsored by the financial institution or any of its affiliates;
- a specific asset class;
- or products with third-party arrangements, that is, revenue sharing.

In addition, the fact that you recommend only products from a select group of issuers could also be a material limitation.

We recognize that, as a practical matter, almost all broker-dealers limit their offerings of securities and investment strategies to some degree. We do not believe that disclosing the fact that a broker-dealer does not offer the entire possible range of securities and investment strategies would convey useful information to a retail customer, and therefore we would not consider this fact, standing alone, to constitute a material limitation. Rather, consistent with the examples of a “material limitation” provided above, whether the limitation is material will depend on the facts and circumstances of the extent of the limitation.

How should you mitigate material limitations on recommendations to retail customers?

You have flexibility to develop and tailor reasonably designed policies and procedures to prevent such limitations and the associated conflicts from causing the broker-dealer or an associated person from placing their interest ahead of the retail customer’s interest.

In developing such policies and procedures, you should, for example, consider establishing product review processes for products that may be recommended, including establishing procedures for identifying and mitigating the conflicts of interests associated with the product, or declining to recommend a product where you cannot

effectively mitigate the conflict, and identifying which retail customers would qualify for recommendations from this product menu.

As part of this process, you may consider:

- evaluating the use of “preferred lists;”
- restricting the retail customers to whom a product may be sold;
- prescribing minimum knowledge requirements for associated persons who may recommend certain products; and
- conducting periodic product reviews to identify potential conflicts of interest, whether the measures addressing conflicts are working as intended, and to modify the mitigation measures or product selection accordingly.

Are certain conflicts of interest required to be eliminated?

You must develop written policies and procedures reasonably designed to eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities and specific types of securities within a limited period of time. These practices, when coupled with a time limitation, create high-pressure situations for associated persons to engage in sales conduct contrary to the best interest of retail customers.

This requirement does not apply to compensation practices based on, for example, total products sold, or asset growth or accumulation, and customer satisfaction.

This elimination requirement would not prevent a broker-dealer from offering only proprietary products, placing material limitations on the menu of products, or incentivizing the sale of such products through its compensation practices, so long as the incentive is not based on the sale of specific securities or types of securities within a limited period of time.

The elimination requirement is not intended to prohibit:

- Training or education meetings, provided that these meetings are not based on the sale of specific securities or types of securities within a limited period of time;
- Receipt of certain employee benefits by statutory employees, as we do not consider these benefits to be non-cash compensation for purposes of Regulation best Interest.

7. What does the Compliance Obligation require?

The Compliance Obligation, as with the Conflict of Interest Obligation, applies solely to the broker-dealer entity, and not to its associated persons.

You must ***establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest***.

This is an affirmative obligation with respect to the rule as a whole, and provides flexibility to allow you to establish compliance policies and procedures that accommodate your business model.

Whether policies and procedures are reasonably designed will depend on the facts and circumstances of a given situation. You should consider, when adopting policies and procedures, the nature of your operations and how to design such policies and procedures to prevent violations from occurring, detect violations that have occurred, and to correct promptly any violations that have occurred.

Your compliance policies and procedures should be reasonably designed to address and be proportionate to the scope, size, and risks associated with your operations and the types of business in which you engage.

In addition to the required policies and procedures, depending on your size and complexity, a reasonably designed compliance program generally would also include:

- controls;
- remediation of non-compliance;
- training; and
- periodic review and testing.

8. Record-making and Recordkeeping

You must meet new record-making and recordkeeping requirements with respect to certain information collected from or provided to retail customers in connection with Regulation Best Interest. This builds upon existing record-making and recordkeeping obligations.

- For each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided, you must keep a record of all information collected from and provided to the retail customer pursuant to Regulation Best Interest, as well as the identity of each natural person who is an associated person, if any, responsible for the account.
- You must retain all records of the information collected from or provided to each retail customer for at least six years after the earlier of the date the account was closed or the date on which the information was replaced or updated.

9. Effective Date

The **effective date** for Regulation Best Interest is **September 10, 2019**. The **compliance date** is **June 30, 2020**.

10. Other Resources

The adopting release for Regulation Best Interest can be found on the Commission's website at https://www.sec.gov/rules/final/2019/34-86031.pdf.

The adopting release for Form CRS Relationship Summary and Amendments to Form ADV can be found on the Commission's website at https://www.sec.gov/rules/final/2019/34-86032.pdf, the Form CRS Instructions can be found on the Commission's website at https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf , and Form ADV General Instructions can be found on the Commission's website at https://www.sec.gov/rules/final/2019/34-86032-appendix-a.pdf.

The Commission Interpretation Regarding Standard of Conduct for Investment Advisers can be found on the Commission's website at https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

The Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser can be found on the Commission's website at https://www.sec.gov/rules/interp/2019/ia-5249.pdf.

11. Contacting the Commission

The Commission's Division of Trading and Markets is available to assist small entities with questions regarding Regulation Best Interest or relating to the package of rules and interpretations adopted on June 5, 2019. You may submit a question by email to IABDQuestions@sec.gov. Additionally, you may contact the Division of Trading and Markets' Office of Chief Counsel at (202) 551-5777.

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[1] This guide was prepared by the staff of the U.S. Securities and Exchange Commission as a "small entity compliance guide" under Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996, as amended. The guide summarizes and explains rules adopted by the SEC, but is not a substitute for any rule itself. Only the rule itself can provide complete and definitive information regarding its requirements.

[2] A dual registrant is an investment adviser solely with respect to those accounts for which a dual registrant provides investment advice or receives compensation that subjects it to the Advisers Act. Although this discussion focuses on the treatment of broker-dealers that are dually registered with the Commission as investment advisers, a broker-dealer should perform the same analysis when it is engaged in other financial services (such as a bank, a commodity trading advisor, or a future commission merchant).

[3] For more information about the "solely incidental" prong, see the Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser.

[4] *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

Modified: Sept. 23, 2019