

Best Interest Standard of Care for Advisors #22

Article By:

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Regulation Best Interest: FINRA Examination Priorities—2020 Examinations for Compliance

The SEC has issued its final Regulation Best Interest (Reg BI), Form CRS Rule, RIA Interpretation and Solely Incidental Interpretation. I am discussing the SEC's guidance in a series of articles entitled "Best Interest Standard of Care for Advisors."

Among the priorities in FINRA's 2020 Risk Monitoring and Examination Priorities Letter

(<https://www.finra.org/rules-guidance/communications-firms/2020-risk-monitoring-and-examination-priorities-letter>) is examining the compliance readiness for Reg BI and Form CRS . . . and then, after June 30, examining compliance with those requirements. Here's what the examination priorities letter says about that, including the questions that their examiners will ask:

Regulation Best Interest (Reg BI) and Form CRS

On June 5, 2019, the U.S. Securities and Exchange Commission (SEC) adopted Reg BI, which establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities, including recommendations of types of accounts. As part of the rulemaking package, the SEC also adopted new rules and forms to require broker-dealers to provide a brief relationship summary—Form CRS—to retail investors. Firms must comply with Reg BI and Form CRS by June 30, 2020.

In the first part of the year, FINRA will review firms' preparedness for Reg BI to gain an understanding of implementation challenges they face and, after the compliance date, will examine firms' compliance with Reg BI, Form CRS and related SEC guidance and interpretations. FINRA staff expects to work with SEC staff to ensure consistency in examining broker-dealers and their associated persons for compliance with Reg BI and Form CRS.

FINRA may take the following factors, among others, into consideration when reviewing for compliance with Reg BI after June 30, 2020:

- *Does your firm have procedures and training in place to assess recommendations*

using a best interest standard?

- *Do your firm and your associated persons apply a best interest standard to recommendations of types of accounts?*
- *If your firm and your associated persons agree to provide account monitoring, do you apply the best interest standard to both explicit and implicit hold recommendations?*
- *Do your firm and your associated persons consider the express new elements of care, skill and costs when making recommendations to retail customers?*
- *Do your firm and your associated persons consider reasonably available alternatives to the recommendation?*
- *Do your firm and your registered representatives guard against excessive trading, irrespective of whether the broker-dealer or associated person “controls” the account?*
- *Does your firm have policies and procedures to provide the disclosures required by Reg BI?*
- *Does your firm have policies and procedures to identify and address conflicts of interest?*
- *Does your firm have policies and procedures in place regarding the filing, updating and delivery of Form CRS?*

Observations:

- While the questions do not explicitly mention the mitigation of advisor incentives, that is likely to be included—perhaps in the question about conflicts of interest.
- The FINRA priorities point out that Reg BI and its best interest standard apply to account recommendations, which includes recommendations for rollovers to IRAs for retirement plans. Broker-dealers need to identify all of the account types that their advisors can recommend and develop processes for determining which account type is in the best interest of a customer.
- Another observation is that the FINRA is asking about the consideration of cost in the development of all recommendations. In my conversations with broker-dealers some, but not all, are already working on the processes that will be used to consider the costs associated with any recommendations. I suspect that both FINRA and the SEC will, beginning June 30, be looking closely at the costs for any investments that have high costs and/or that have imbedded costs that are not transparent to investors. The examiners will likely ask broker-dealers to justify the higher costs.
- One last comment—for now—is that current disclosures may need to be enhanced under Reg BI. That’s because Reg BI has changed the disclosure to “full and fair” disclosure, which is the

same as the standard applied to investment advisers. To understand the significance of that, you need to look no further than the SEC's Share Class Selection Disclosure Initiative.

Conclusion:

As they say, forewarned is forearmed. Now is the time for broker-dealers to be working on the decisions for [compliance with Reg BI](#) and particularly with the disclosure, conflicts and mitigation issues, as well as complying with the care obligation, including the consideration of costs.

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