

The Second Phase of the SEC's Reg BI Exams

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Closing out 2020, the SEC's Division of Examinations (OCIE) issued a [Statement on Recent and Upcoming Regulation Best Interest Examinations](#). There the Division of Examinations announced its intention "to begin its next phase [of Reg BI examinations] by conducting more focused examinations ... beginning in January 2021."

The statement describes that two main points of the SEC's focus will be on requirements of Reg BI that extend beyond customer-specific suitability alone, including:

1. that broker-dealers need to have a reasonable basis to believe that recommendations are in retail customers' best interests; and
2. by conducting enhanced transaction testing designed to examine whether broker-dealers have implemented effectively their written policies and procedures.

Delving further into these broad categories, the statement advises that the SEC's specific focus areas during this next phase include:

- Continued evaluation of firm policies and procedures, including evaluating specific firm processes for compliance with Reg BI, and alterations to firm product offerings, including the removal of higher cost products when lower cost products are available.
- Evaluation of how firms have considered costs in making a recommendation, which may include:
 - what information is available to firm personnel to identify relevant costs;
 - how any such information has been used; and

- any documentation of the consideration of costs.

- Evaluation of the processes firm personnel have used to make recommendations to new customers – for example, if a firm recommended a rollover from an employee benefit plan, examiners will assess: what information was gathered from new customers; what disclosures were made at the time; how alternatives were considered; and what documentation was retained.
- Evaluation of the processes firm personnel have used to recommend complex products, including what information was available and used to consider reasonably available alternatives.
- Evaluation of the processes that firms have used to identify and address conflicts related to recommendations.

Of note, first is the SEC's repeated discussion of costs and the heightened focus it advised its examination staff will apply to product costs. Firms will need to be prepared to justify that their registered representative recommendations in light of costs and that their supervision and compliance processes surrounding higher-cost product recommendations are justified, documented, and truly in the best interests of their clients. Second, as the SEC has been advising for some time, the Division of Examinations will be scrutinizing rollover recommendations in a more intense manner than in years past. Third and finally, and not surprisingly, the Division of Examinations will be scrutinizing whether recommendations for customers to invest in complex products are in their best interests.

The Division of Examinations has wasted no time in rolling out this next phase. Indeed, Faegre Drinker's Best Interest Compliance Team has learned that the examination staff have already propounded the document and information requests to certain firms for this next wave, and we have obtained and analyzed one such information/document request.

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