



What You Need to Know About the SEC Regulation Best Interest (Reg BI)

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Is your **broker** acting in your best interest? A new set of rules that aim to increase your confidence will become effective at the end of June.

The Securities and Exchange Commission (SEC) has outlined the conduct that broker-dealers and associated persons must follow when they recommend certain securities transactions to retail clients. **The new set of rules is known as Reg BI** shorthand for **Regulation Best Interest**.

The new SEC Reg BI rules establish industry-wide standards to ensure brokers put the best interests of retail investors first. After the rules come into effect on June 30, 2020, retail clients should start to receive specific information from broker-dealers when they make recommendations regarding securities transactions.

Along with Regulation Best Interest, the SEC also created forms broker-dealers—and investment advisors—must give to new and existing clients. One of the new documents is **Form CRS**, which stands for client relationship summary. This new form will use easy-to-understand language (“plain English”) to help retail investors evaluate the types of services they can expect and better understand the relationship between firms and clients. The form is strictly limited in page length (see below) and is designed to empower investors to make informed decisions when choosing a new broker or advisor (or continuing an existing relationship).

In Your Best Interest

The SEC sought to create a standard for all types of brokerage accounts, rather than relying on rules issued by some states and previous legislation that only oversaw retirement accounts. To avoid some of



the thorniness that surrounds the word “fiduciary,” but yet offer similar advice, the SEC is using the term “best interest.” Here are a few main points.

Eliminate, mitigate, disclose. At its core, the best interest rule means brokers must eliminate conflicts of interest whenever possible. When this is not entirely possible, brokers should mitigate any potential conflicts of interest and make sure they’re properly disclosed to clients. The best interest standard requires that the broker put the client’s interest first (ahead of the broker’s), and that financial advice is not influenced by how or if the broker is compensated.

Brokers are subject to the Financial Industry Regulatory Authority (FINRA) suitability standard, which requires they have a reasonable basis to believe that an investment recommendation is suitable for a client, based on the client’s investment profile. They also have to take steps to understand the client’s needs, goals, and financial situation to make sure any recommendation would be appropriate for the client. (FINRA is a self-regulatory organization that enforces SEC rules.)

Education vs. recommendation. If the communication between brokers and clients is limited to education, Reg BI doesn’t apply. The key part of Reg BI is if a recommendation is made. The rule applies whenever a broker recommends security transactions or investment strategies involving securities, opening a specific account type, or moving assets from one account type to another (like rolling over from a 401(k) to an IRA).

Any type of communication that could be construed to be a suggestion to take action and “reasonably would influence an investor to trade a particular group of securities,” as the SEC said, falls under Reg BI.

Beyond suitability. Regulation Best Interest mandates that brokers serve under a higher standard of care beyond suitability. They must not put their financial interest ahead of clients’ interests. When brokers make any securities recommendations to existing or prospective clients, they are now mandated to send Form CRS and any other Reg BI disclosures at or before the time of the recommendation.

Reg BI applies to broker-dealers but not to Registered Investment Advisors (RIAs), which are still held to the “fiduciary” standard under the Investment Advisors Act of 1940. However, RIAs are required to comply with all the requirements of Form CRS.



Speaking of Form CRS

The client relationship summary is intended to provide an easy way for investors to understand and compare what's being offered at a broker versus an investment advisor, as well as compare companies across the industry. Both brokers and advisors need to send these forms to existing and new clients.

The form spells out in plain English the relationship between the investor and the financial services institution, including whether the firm is a broker-dealer, an investment advisor, or a dual registrant. (TD Ameritrade, Inc., is a broker-dealer that also has a dual-registered status as an investment advisor.)

Brief and accessible, Form CRS aims to reduce the reams of paperwork that people are disinclined to read. It uses consumer-friendly language to present a simple overview of the client-firm relationship. The document must be only two pages long if the entity is just a broker-dealer or just an investment advisor. Dual registrants' forms can be four pages long. Online versions can include links to additional information for investors who are interested in learning more.

The form also includes SEC-specific language that the agency calls "conversation starters" to help clients and prospective clients ask questions to their broker or advisor.

There are five specific sections:

- An introduction that explains how broker and advisory services and fees are different
- A section describing the type of relationship and services offered
- Fees, costs, conflicts, and standards of conduct, including a firm's legal obligation and how they make money
- Disciplinary history
- Where to find more information

The forms must go out to all existing account owners by July 15.

Bottom Line on Reg BI and Form CRS

A financial form that offers conversation starters? This could be the springboard for a deeper engagement with your firm. Consider it an opportunity to make sure you're on track with your financial



goals. Has your life situation changed since the last time you connected with your broker or advisor? Perhaps it's time to review.

The goals of Reg BI and Form CRS are to empower clients and to make the relationship between the broker, advisor, and client more transparent and understandable. It's all about making sure the people you trust to help you pursue your financial objectives are in alignment with you.

IMPORTANT DISCLOSURES

The information presented here is not specific to any individual's personal circumstances.

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