

Legal Update

SEC's OCIE Risk Alerts – Examination Focus on Compliance with Regulation Best Interest and Form CRS

On April 7, 2020, the U.S. Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") issued two companion risk alerts on compliance with Regulation Best Interest ("Reg. BI") and Form CRS.¹ These risk alerts provide broker-dealers and investment advisers with advance information about the expected scope and content of the initial examinations for compliance with Reg. BI and Form CRS, both of which have an upcoming compliance date of June 30, 2020.

The timing of these risk alerts is particularly interesting given the April 2, 2020 statement by SEC Chairman Jay Clayton regarding, among other matters, the June 30 compliance date amidst the COVID-19 pandemic. His statement not only affirms the compliance date but also appears to acknowledge the challenges presented by COVID-19:

Over the past ten months, the Commission and the staff have engaged extensively with broker-dealers, investment advisers, retail investors and other market participants, as well as FINRA and other regulatory partners, regarding the implementation of Reg BI and Form CRS. We believe firms with account relationships comprising a substantial majority of retail

investor assets have made considerable progress

Based on that engagement—and because the continued implementation of these conduct and transparency initiatives, individually and collectively, will significantly benefit Main Street investors—we believe that the June 30, 2020 compliance date for Reg BI and other requirements, including the requirement to file and begin delivering Form CRS, remains appropriate.

[F]irms should continue to make good faith efforts around operational matters to ensure compliance by June 30, 2020, including devoting resources as necessary and available in light of the circumstances. To the extent that a firm is unable to make certain filings or meet other requirements because of disruptions caused by COVID-19, including as a result of efforts to comply with national, state or local health and safety directives and guidance, the firm should engage with us. I expect that the Commission and the staff will take the firm-specific effects of such unforeseen circumstances (and related operational constraints and resource needs) into account in our examination and enforcement efforts.²

Reg. BI Risk Alert

OCIE is set to begin examinations to assess implementation of Reg. BI. Initial examinations will likely occur during the first year after the compliance date and will be primarily intended to evaluate whether firms have:

- Established policies and procedures reasonably designed to achieve compliance with Reg. BI
- Have made “reasonable progress” in implementing those policies and procedures as necessary or appropriate, including making modifications as may be necessary or appropriate in light of information gained from the implementation process and other facts and circumstances

On a more cooperative note, OCIE staff noted that it stands ready to work with firms and other SEC staff on issues that may arise in the course of examinations and understands that COVID-19 has created challenges for firms. In a footnote, however, OCIE staff highlights that while the SEC

and staff across divisions and offices continue to monitor the effects of COVID-19 on market participants, including broker-dealers, the SEC has not extended the compliance date and warns that OCIE staff remains fully operational nationwide and continues to execute its investor protection mission (echoing Chairman Clayton’s statement regarding the importance of Reg. BI to investor protection).

The risk alert then explains that initial examinations will focus on assessing whether firms have made a good faith effort to implement policies and procedures reasonably designed to comply with Reg. BI, including the operational effectiveness of broker-dealers’ policies and procedures. The alert breaks down the primary topics of OCIE’s examination focus by the four component obligations of Reg. BI’s general obligation to make a recommendation in a retail customer’s best interest. The primary areas of focus are outlined in the chart below.

<p>Disclosure Obligation</p>	<p><i>OCIE may assess how the firm has met the requirement to disclose material facts relating to the scope and terms of its relationship with a retail customer, including (i) capacity in which a recommendation is made, (ii) fees and costs and (iii) limitations on securities or investment strategies that may be recommended.</i></p> <p><i>In order to assess content and timing of disclosures, OCIE may review:</i></p> <ul style="list-style-type: none"> • Schedules of fees and charges and related disclosures • Compensation methods for registered personnel and related conflicts of interest • Disclosures related to account monitoring • Disclosures on material limitations on accounts or services recommended to retail customers • Lists of proprietary products sold to retail customers
<p>Care Obligation</p>	<p><i>To assess whether a broker-dealer is acting in accordance with the appropriate standard of care, OCIE may review:</i></p> <ul style="list-style-type: none"> • Information collected to create retail customer investment profiles • Processes for determining a recommendation is in the best interest of a retail customer, including consideration of the related risks, rewards, costs and conflicts of interest • Processes related to recommendations for significant investment decisions (such as rollovers or account recommendations) and complex, risky or expensive products

Conflict of Interest Obligation	<p><i>OCIE may review whether and how a broker-dealer's policies and procedures and related documentation address:</i></p> <ul style="list-style-type: none"> • Structures put in place to identify conflicts for the broker-dealer or its associated persons • Conflicts associated with material limitations on the securities or strategies that may be recommended to a retail customer • Identification and assessment of conflicts as the broker-dealer's business evolves • Disclosure, mitigation and elimination of conflicts and the related processes for making that determination, particularly where certain conflicts are required to be eliminated by Reg. BI
Compliance Obligation	<p><i>OCIE may review a broker-dealer's policies and procedures to assess Reg. BI compliance, with a particular focus on:</i></p> <ul style="list-style-type: none"> • Any controls, remediation of noncompliance, training, and periodic review and testing

Form CRS Risk Alert

The Form CRS risk alert begins by setting what we hope to be a cooperative tone by stating that initial examinations will focus on assessing whether firms have made a good faith effort to implement Form CRS. Like the Reg. BI risk alert, this risk alert states that OCIE is ready to work with firms and other SEC staff on issues that may arise in the course of examinations and understands that COVID-19 has created challenges for firms. But it also includes a similar warning: "While the Commission and staff across Commission divisions and offices continue to monitor the effects of COVID-19 on market participants, including investment advisers and broker-dealers, the Commission has not extended the compliance date for Form CRS. OCIE staff remains fully operational nationwide and continues to execute its investor protection mission."

With that in mind, we explore the risk alert's important considerations related to the content of the relationship summary and the processes firms will need to undertake in order to meet the associated requirements.

- **Filing:** OCIE will review whether a firm has filed its relationship summary, including any amendments, with the appropriate depository and posted it on the firm's website for public access.
- **Delivery:** OCIE will also evaluate delivery processes and review policies and procedures for whether and how they address required delivery processes and dates, with special attention toward whether firms have complied with their initial delivery obligation as Form CRS compliance gets off the ground. OCIE staff may review records of dates on which each relationship summary was provided to validate whether existing and new retail investors properly received their relationship summary.
 - **Existing Retail Investors:** Firms must complete initial delivery to existing retail investors **by July 30, 2020**, and before or at the time of (i) a new account opening, (ii) a rollover recommendation or (iii) a recommendation of a new brokerage or investment advisory service or investment that would not be held in an existing account.
 - **New Retail Investors:** Delivery to a new retail investor must occur before or at the

earliest of (i) entering into an investment advisory contract, (ii) making a securities transaction, account or investment strategy recommendation, (iii) placing an order or (iv) opening a new brokerage account.

- **Content:** Firms should ensure that their relationship summary includes all required information and that it is true, accurate and not misleading. OCIE may review for information regarding:
 - Descriptions of relationships and services offered, including monitoring and investment authority
 - Fees and costs, including the principal fees and costs and other fees relating to services and investments paid by retail investors directly or indirectly (OCIE may review fee schedules, advisory agreements and brokerage agreements and compare the fees listed in those documents against the fees listed in the relationship summary)
 - Compensation of financial professionals, cash or non-cash, and related conflicts of interest
 - Conflicts of interests of the firm, including incentives relating to proprietary products, third-party payments, revenue sharing and principal trading
 - Legal or disciplinary history of the firm or its financial professionals
- **Formatting:** Form CRS should be formatted in accordance with the Form CRS instructions. Firms should consider whether they have followed each instruction, e.g., the plain English requirement or requirements for particular wording or text features.
- **Updates:** OCIE may review policies and procedures for updating the relationship summary. A firm should consider (i) how and whether it updates Form CRS within 30 days of information becoming materially inaccurate or communicates such changes to retail investors within 60 days and (ii) the

processes for highlighting or summarizing recent material changes.

- **Recordkeeping:** To assess compliance with delivery and recordkeeping obligations, OCIE may review (i) records related to relationship summary delivery and (ii) policies and procedures regarding creation and maintenance of records.

Takeaways

The risk alerts provide a useful framework detailing the primary high-level concerns for broker-dealers and investment advisers when gauging their Reg. BI and Form CRS preparedness. However, OCIE does not provide an exhaustive list of potential examination targets, and the required compliance measures may vary from firm to firm. Additionally, SEC staff do not appear to yield to certain current challenges, particularly those of an operational nature, that firms are experiencing as a result of COVID-19 related disruptions.

As mentioned above, in a recent public statement, Chairman Clayton reiterated the SEC's dedication to Reg. BI and Form CRS as important investor protection measures. Although acknowledging the challenges caused by COVID-19, the SEC is prepared to move forward with Reg. BI and Form CRS as of the scheduled compliance date of June 30, 2020. OCIE is expected to begin examinations to assess firms' Reg. BI and Form CRS implementation not long after the compliance date, so firms should prepare now for their implementation of these programs. We hope that SEC staff will act in accordance with Chairman Clayton's words and take firms' "good faith efforts" and firm-specific effects of these unforeseen circumstances (and related operational constraints and resource needs) into account in SEC examination (and enforcement) efforts.

For more information on the SEC's Reg. BI and Form CRS initiatives or if you would like to engage Mayer Brown to assess your firm's Reg. BI and Form CRS preparedness or to contact SEC staff on your behalf, please contact any of the following Mayer Brown attorneys.

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If you wish to receive regular updates on the range of the complex issues confronting businesses in the face of the novel coronavirus, please [subscribe](#) to our COVID-19 "Special Interest" mailing list.

And for any legal questions related to this pandemic, please contact the authors of this Legal Update or Mayer Brown's COVID-19 Core Response Team at FW-SIG-COVID-19-Core-Response-Team@mayerbrown.com.

Endnotes

¹ Sec. & Exch. Comm'n, OCIE Risk Alert, *Examinations that Focus on Compliance with Regulation Best Interest* (Apr. 7, 2020), <https://www.sec.gov/files/Risk%20Alert-%20Regulation%20Best%20Interest%20Exams.pdf>; Sec. & Exch. Comm'n, OCIE Risk Alert, *Examinations that Focus on Compliance with Form CRS* (Apr. 7, 2020), <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf>

² Chairman Jay Clayton, *Investors Remain Front of Mind at the SEC: Approach to Allocation of Resources, Oversight and Rulemaking; Implementation of Regulation Best Interest and Form CRS* (Apr. 2, 2020), <https://www.sec.gov/news/public-statement/statement-clayton-investors-rbi-form-crs>

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