



**REGULATION
BEST INTEREST:
HOW NOT TO GET
SUED**

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BACKGROUND



Mound Cotton
represents BDs, RRs
and RIAs in arbitration
and litigation



Regulatory



NY, NJ, FL, CT, CA, TX



Adjunct Prof. at FUSL



FOL



INTENT OF REG. BI

- **Preserve access and choice in:**
 - **Type of professional**
 - **Services received**
 - **How those services are paid**

ORIGIN: DODD FRANK ACT OF 2010



CONGRESS: SEC TO CONSIDER
UNIFORM FIDUCIARY STANDARD



CUSTOMERS CONFUSED
BETWEEN RIAs AND RRS





WHAT HATH DODD-
FRANK WROUGHT?



SEC directed to write
report on fiduciary
standard

Report recommended
uniform fiduciary
standard

The Commission "may"
promulgate a uniform
fiduciary standard

(Discretionary with the
SEC)

Avoid
Confusion
among
investors

Difference
between
IARs and
RRs.

Two-
hatted
advisors

Ill-fated
DOL rule:
3
standards

PURPOSE OF DODD-FRANK UNIFORM FIDUCIARY RULE



June 1 Oral argument



Plaintiffs are Seven States and a network of Investment Advisers



States argue that DFA requires uniform fiduciary standard



Plus DFA concern about confusion with 2 standards



Reg BI: 3 standards

SECOND CIRCUIT COURT OF APPEALS CASE UPDATE





SECOND CIRCUIT ARGUMENTS

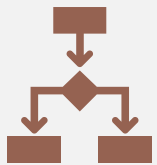
- SEC says DFA is optional
- Deference to SEC
- Preserve investor choice
- Small investors lose access
- Vetted by industry/investor groups
(Comment letters)



Uniform legal standard for registered investment advisers and broker dealers



RIA plaintiff: BD are underregulated



Decision expected?

**PLAINTIFF'S
REQUEST**



Fiduciary: Client's interest is paramount

Ongoing duty to monitor and advise

Imposed on IARs under '40 Act

(Investment advice for compensation)

Disclose and avoid conflicts

Generally fee-based

FIDUCIARY VS. SUITABILITY



SUITABILITY STANDARD FINRA RULE 2111

- Suitability: Reasonable recommendation
- Based on KYC factors, information disclosed by customer
- No duty to monitor, advise to sell
- No holder liability (must be purchase or sale)
- <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111>



**Applied on top of
Suitability Standard**

**Graft to IAR
standards**

**Includes disclosures
in Form CRS/ ADV-3**

SEC REPORT CARD

- SEC avoiding confusion in legal standards?





REGULATION BI COMPONENTS



Full and fair disclosure of the firm-customer relationship



Conflicts of interest associated with recommendation



Relationship nature: Advisory or Brokerage?



Nature of comp



In form CRS/ADV-3

DISCLOSURE OBLIGATION



CARE OBLIGATION



Heightened standard
at time of
recommendation



Understand potential
risks, rewards, costs
of recommendation



Recommendation is
in best interest of
retail customers



Series of
recommended
transactions not
excessive



Selection of account



Suitable for
anyone

Suitable for
this
customer

Appropriate
quantity

THREE PRONGED SUITABILITY RECOMMENDATION



Put customer
interest first

Retail customers
only

Time of
recommendation

Not fiduciary

No duty to
monitor (unless
agreement to
monitor)

Applies to
choice of
account

BEST INTEREST STANDARD



Conflicts must be disclosed/mitigated

Careful about sales contests or quotas

Customers' interest most important

Disclosure of general magnitude of compensation

Promissory notes and performance standards?

Reasonably available alternatives

**CONFLICT OF
INTEREST
OBLIGATION**





Higher commissions for house products



E.g. Boiler Room RIP scene



Incentive RR to recommend products which benefit them?



SEC: needn't be cheapest service



Document need for pricier service

BAD BOGEYS





Big commission grid jumps



Sponsor inducements, trips,
gifts

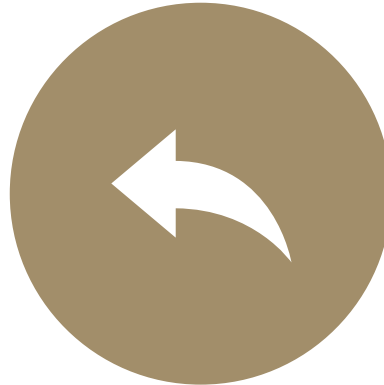
**OTHER
POTENTIAL
CONFLICTS**



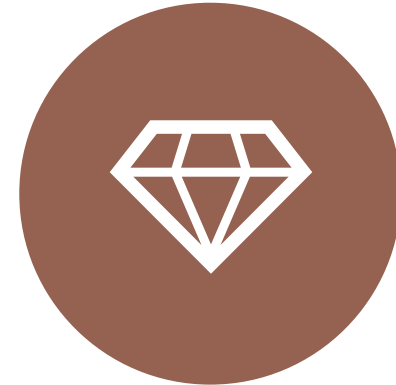
CHOICE OF ACCOUNT



DOL FAVORED FEE-BASED



REVERSE CHURNING



SEC WANTED TO PRESERVE
INVESTOR CHOICE FOR
SMALLER INVESTORS



COMPLIANCE OBLIGATION



EDUCATING BROKERS AND
DISCLOSURES TO
CUSTOMERS



POLICIES, PROCEDURES,
SALES PRACTICES, AND
SUPERVISORY MANUALS



GOOD FAITH COMPLIANCE



Furnish to retail
customers

2-page limit

Introduction to firm

Description of fees/costs

Disciplinary history

Required when new
account opened or new
recommendation made

Explain whether
advisory or B-D

FORM CRS RELATIONSHIP SUMMARY



FORM ADV 3

Investment
advisers must
furnish to
customers

Same as CRS

2-page limit

Introduction to
firm

Description of
fees/costs

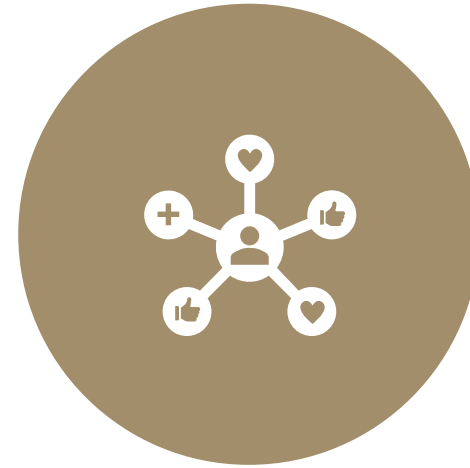
Disciplinary
history



DUAL REGISTRANTS



**MAY PROVIDE ONE
SINGLE FORM CRS**



**EVEN IF IAR AND BD
ARE AFFILIATES**





**TIPS FOR
BROKER-DEALERS**



Ramp up for
compliance
with Reg BI



**TIPS FOR
BROKER-DEALERS**



**Get Form
CRS in order**



**TIPS FOR
BROKER-DEALERS**

Ensure brokers
are not
portrayed as
financial
advisers



**TIPS FOR
BROKER-DEALERS**



**Prepare
compliance
materials**



**Conflicts of interests
and failures to
disclose**



**Fiduciary standard
for respondent
broker**



Burden shift to broker



**Documentation for
recommendations
and alternatives**

ROADMAP FOR CLAIMANT'S COUNSEL





Standard is more than FINRA Rule 2111



Legalistic arguments



Claimants have more ammunition



BD must show alternatives considered



Arbitrators' views: intuitive

PRACTICAL EFFECT ON CUSTOMER CLAIMS




10 WAYS TO GET SUED




HOW TO GET SUED!

- Do not review your RRs' business cards, emails, letterheads and signage
- RRs are not FAs





**HOW TO GET
SUED!**




Do not have or
document
training on
Reg BI




HOW TO GET SUED!


Do not
monitor RRs
fee and
Commission
schedules




HOW TO GET SUED!



Continue doing
business as usual
and defer to RR
for whether to
charge
commissions



HOW TO GET SUED!



Permit long term
buy and hold
customers to
pay annual
advisory fee

Allow
lucrative
incentive
compensation
from sponsors


Higher comp
for house
products

HOW TO GET SUED!

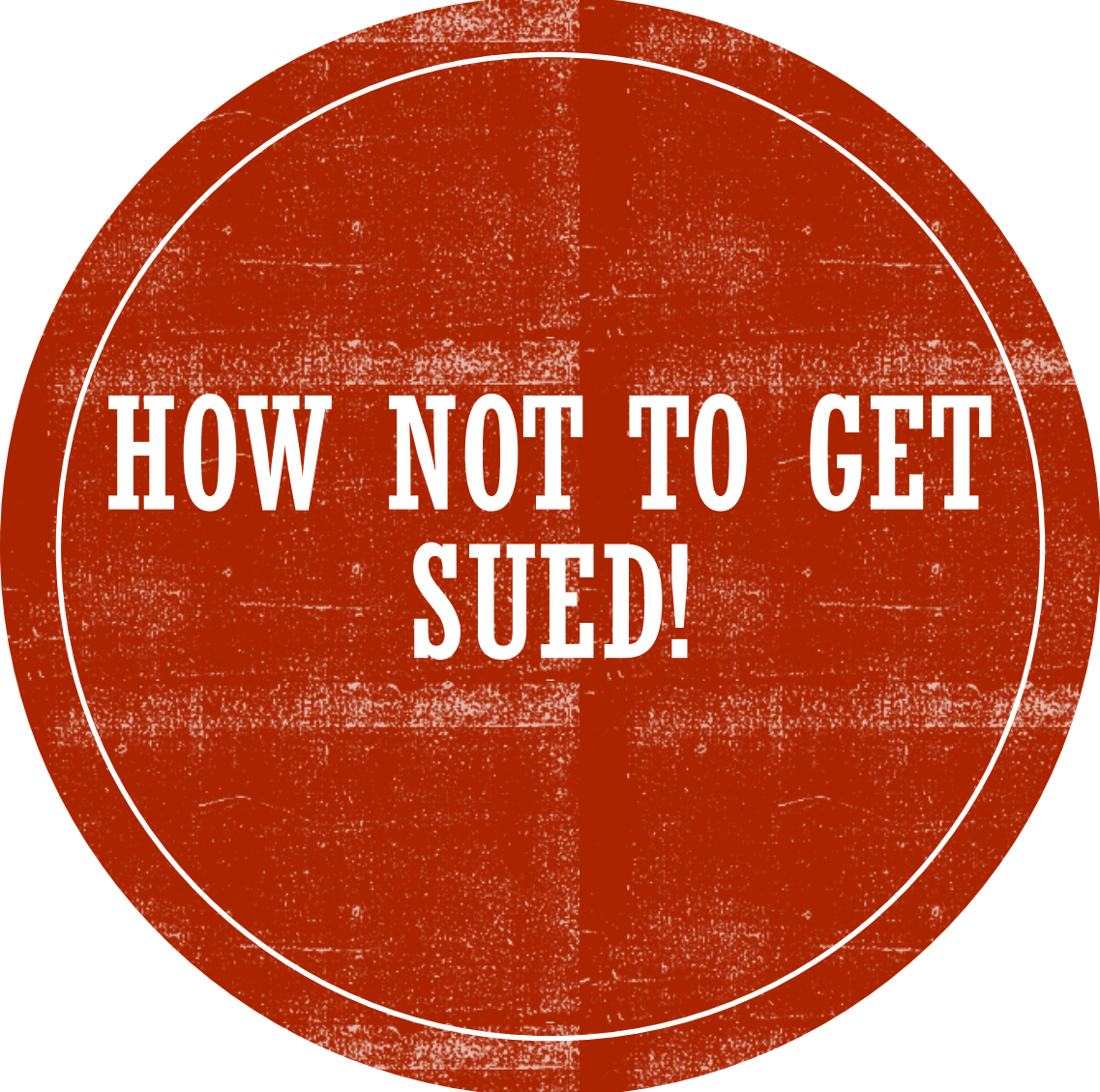





**HOW TO GET
SUED!**



**Continue to
use existing
SPM**



**HOW NOT TO GET
SUED!**



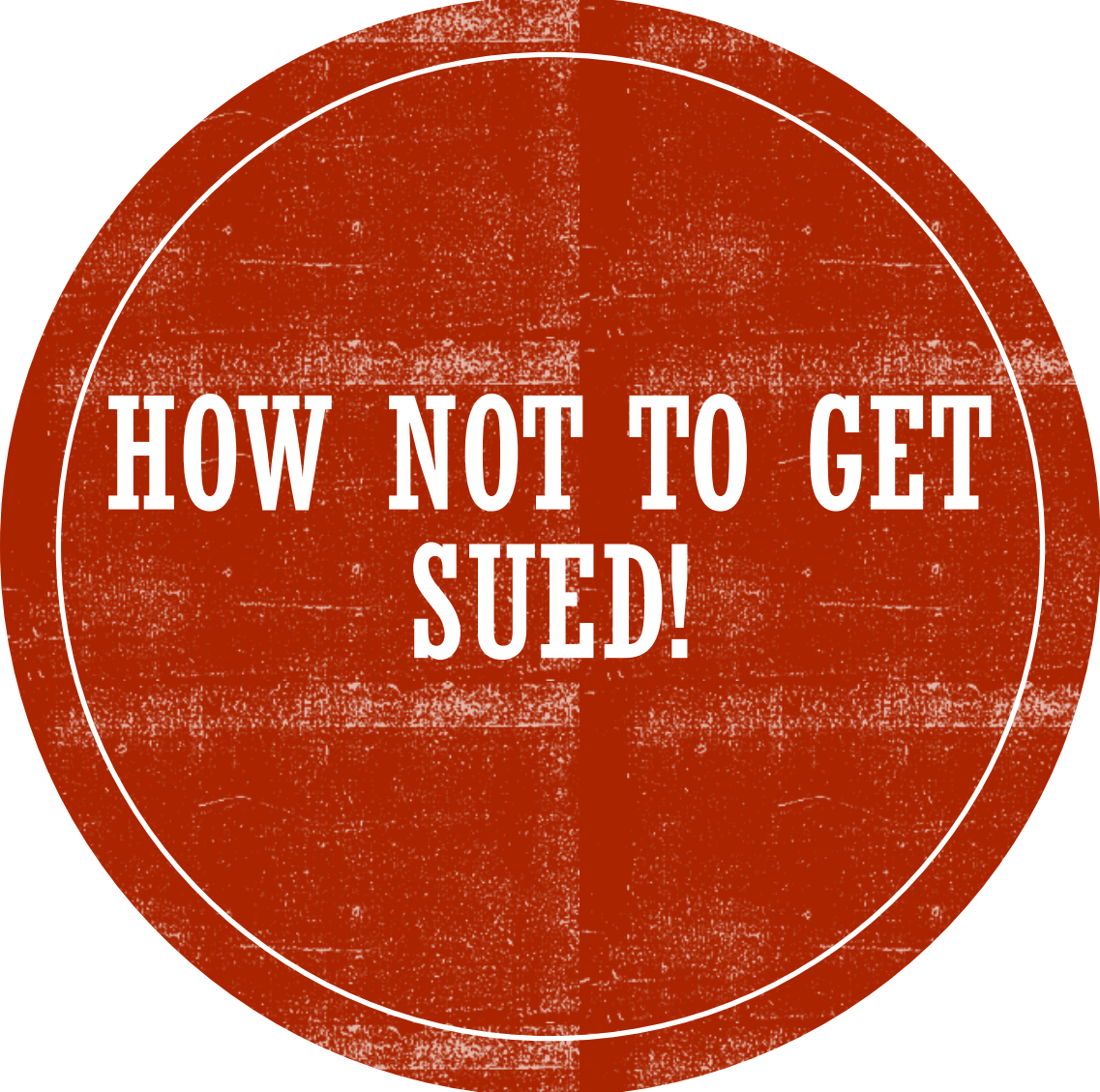
Have training on
Reg. BI, and
keep records
proving that
your RRs
attended

HOW NOT TO GET SUED!

Review your RRs' business cards, email signatures, and signage to avoid moniker "adviser"

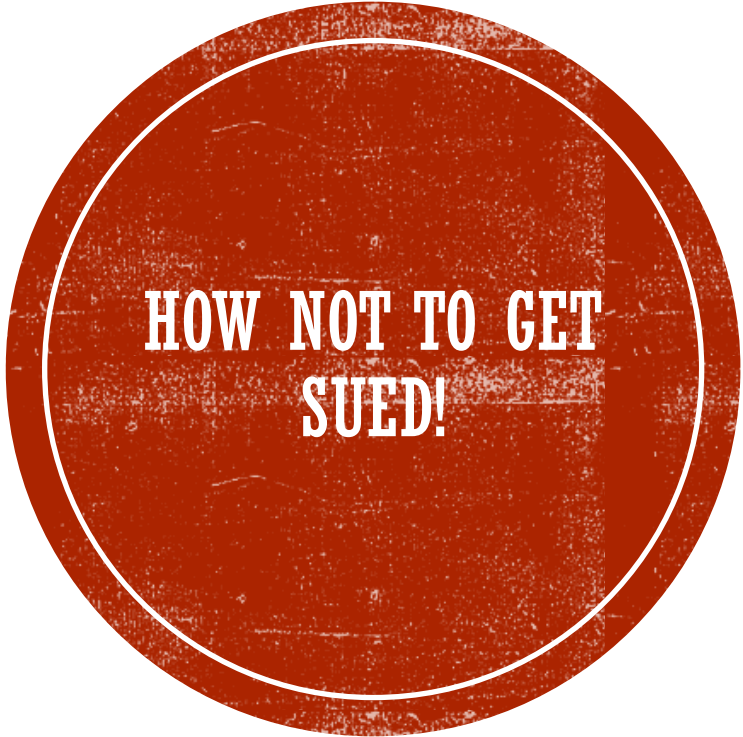
(Unless registered as IAR, CTA)





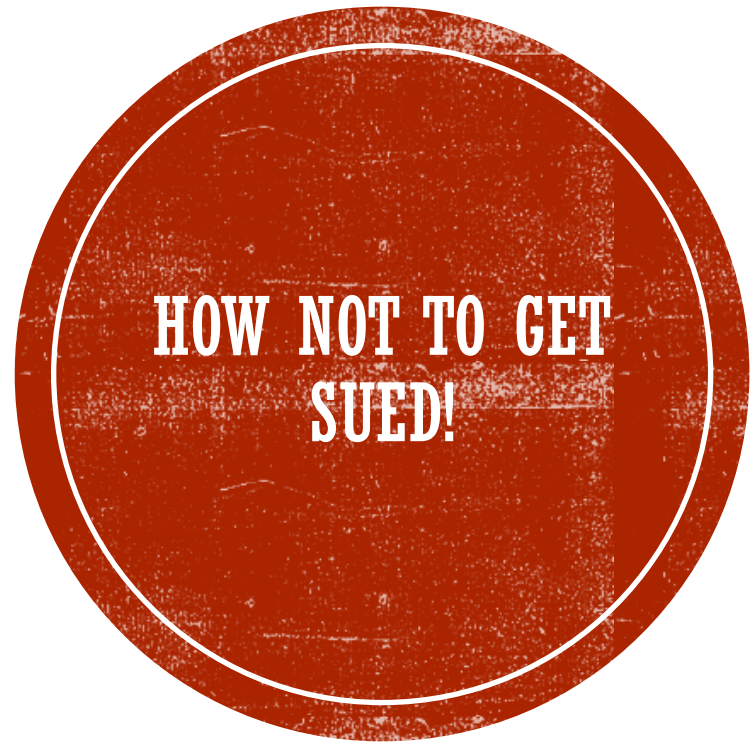
HOW NOT TO GET SUED!

Ensure that your
RRs are not
charging one size
fits all
fees/commissions



**HOW NOT TO GET
SUED!**

- **Document and justify each customer's choice of account, whether advisory or commission based**



Monitor accounts
to avoid reverse
churning

One size fits all
RRs?

HOW NOT TO GET SUED!



AVOID PRODUCT-BASED OR
PRODUCT-SPECIFIC INCENTIVE
COMPENSATION



WATCH BIG JUMPS IN GRID
COMPENSATION

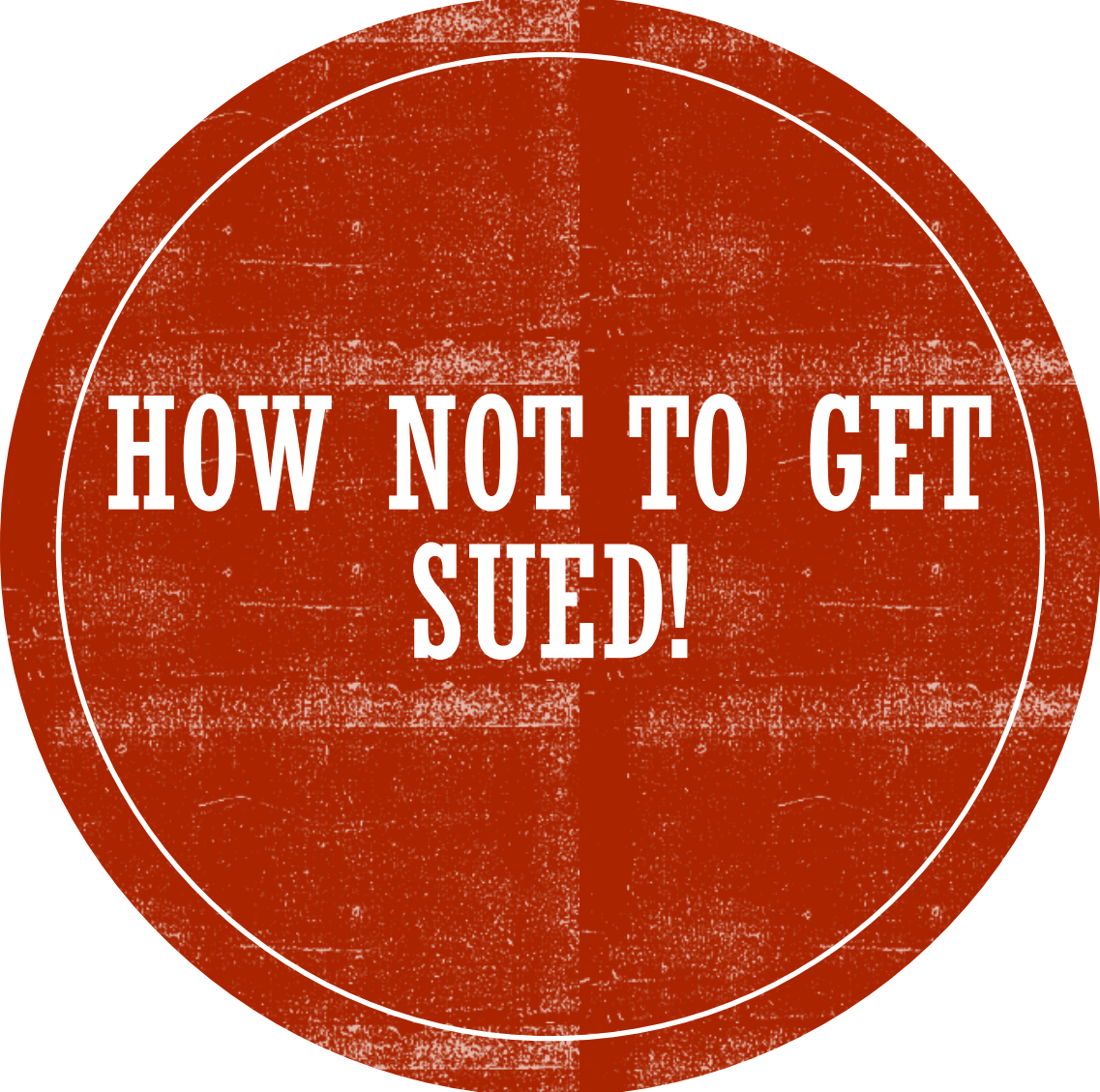


**Document
other
alternatives
considered**


**Get customer
to acknowledge**

**HOW NOT TO
GET SUED**





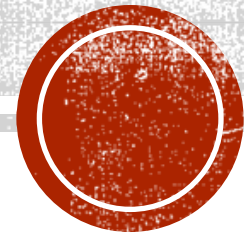
**HOW NOT TO GET
SUED!**



Update SPM to
include training
on BI and
conflict-
avoidance



QUESTIONS / COMMENTS



THANK YOU



FOR FURTHER
QUESTIONS CALL:



1-800-T E M K I N

