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REGULATION BEST INTEREST: EMERGING ARBITRATION, REGULATORY, AND ENFORCEMENT DEVELOPMENTS

In this article, the authors catalogue the latest key developments surrounding Reg BI in both the arbitration and enforcement spaces. They conclude by highlighting important takeaways from recent matters for broker-dealers and practitioners alike.

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In June 2019, the U.S. Securities and Exchange Commission (“SEC”) adopted Regulation Best Interest (“Reg BI”), which set forth “a new standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy (including account recommendations) to a retail customer.”¹ That standard of conduct included Reg BI’s “Best Interest Obligation,” which would require brokers, dealers, and natural persons who are associated persons of a broker or dealer to “act in the best interest of the retail customer at the time the recommendation is made,

without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.”² The SEC set forth parameters and offered some guidance for how broker-dealers and associated persons would comply with the Best Interest Obligation. Namely, broker-dealers and associated persons would be required to adhere to four component obligations: the “Disclosure Obligation,” the “Care Obligation,” the “Conflict of Interest Obligation,” and the “Compliance Obligation.”³

After Reg BI went into effect on June 30, 2020, a period of dormancy followed during which neither the

¹ Chairman Jay Clayton, *Confirmation of June 30 Compliance Date for Regulation Best Interest and Form CRS*, U.S. SECURITIES AND EXCHANGE COMMISSION (June 15, 2020), <https://www.sec.gov/news/public-statement/clayton-compliance-date-regulation-best-interest-form-crs>; *see also* 17 C.F.R. § 240.15l-1 (2022); SEC Rel. No. 34-86031 (2019).

² 17 C.F.R. § 240.15l-1(a)(1) (2022).

³ § 240.15l-1(a)(2)(i)-(iv); *see also* SEC Rel. No. 34-86031, at 13 (2019).

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SEC nor the Financial Industry Regulatory Authority (“FINRA”) brought any enforcement actions for alleged Reg BI violations. Similarly, few customers brought arbitration claims relating to Reg BI.⁴ During that period, firms and practitioners could only speculate as to the substance of a claimed Reg BI violation. In 2019, the SEC stated that Reg BI would “enhance[] the broker-dealer standard of conduct beyond existing suitability obligations, and align[] the standard of conduct with retail customers’ reasonable expectations.”⁵ Yet, without concrete enforcement examples, it was challenging for firms and practitioners to glean what such obligations would require in practice and how they would differ from then-existing suitability obligations.

That has begun to change, however, with the emergence of the first meaningful Reg BI developments in the arbitration and regulatory enforcement spaces in 2022 and 2023. With respect to arbitration, Reg BI claims are, for the first time in 2022 and 2023, among the top 15 controversy types in customer arbitrations.⁶ With respect to enforcement, the SEC and FINRA each brought their first significant enforcement actions alleging Reg BI violations in 2022 and 2023.⁷ Accordingly, this article catalogues the latest key developments surrounding Reg BI in both the arbitration and enforcement spaces, and highlights important takeaways from recent matters for broker-dealers and practitioners alike.

ARBITRATION DEVELOPMENTS

The SEC has stated that it does not contemplate Reg BI to “create any new private right of action or right of

recission,” or intend for Reg BI to have such a result.⁸ Nevertheless, according to FINRA’s Dispute Resolution Statistics for 2023, Reg BI claims are now among the top 15 controversy types in customer arbitrations.⁹ As of March 30, 2023, 101 arbitration cases served in 2023 have involved alleged Reg BI violations.¹⁰ In 2022, 216 arbitration cases served involved Reg BI claims.¹¹ In contrast, in 2021, only 27 arbitration cases served involved Reg BI claims.¹² At this stage, there are few publicly available arbitration awards on FINRA’s website that might provide insight into the nature or viability of Reg BI claims.¹³ Yet, the significant uptick in Reg BI-related arbitrations demonstrates that firms should be prepared to defend against customer arbitrations that relate to Reg BI.

Although, thus far, little substantive guidance can be gleaned from the publicly available Reg BI arbitration decisions, firms and practitioners might look to other sources to gain a deeper understanding of the practical requirements of Reg BI. In particular, recent guidance from the SEC and FINRA may be instructive as to what regulators may deem to constitute a violation of the broker-dealer standard of conduct.

SEC AND FINRA EXAM AND ENFORCEMENT DEVELOPMENTS

Most of the recent substantive guidance that has emerged in 2022 and 2023 regarding Reg BI has come from the SEC and FINRA in the form of released guidance and enforcement actions. This article focuses, in particular, on February 2022 Reg BI findings from FINRA’s Examination and Risk Monitoring Program;

⁴ FINRA Dispute Resolution Services, *Dispute Resolution Statistics*, FINRA (last visited May 4, 2023), <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics>.

⁵ SEC Rel. No. 34-86031, at 5 (2019).

⁶ *Dispute Resolution Statistics*, *supra* note 4.

⁷ Complaint, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022); *In re Malico*, FINRA AWC No. 2021069405501 (Oct. 11, 2022).

⁸ SEC Rel. No. 34-83601, at 43 (2019).

⁹ *Dispute Resolution Statistics*, *supra* note 4.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ FINRA Dispute Resolution Services, *Arbitration Awards Online*, FINRA (last visited May 4, 2023), <https://www.finra.org/arbitration-mediation/arbitration-awards-online>.

the SEC’s first Reg BI complaint, *S.E.C. v. Western International Securities, Inc.*; and FINRA’s first Reg BI enforcement actions, *In re Malico*, *In re Cirella*, *In re Short*, *In re Long Island Financial*, and *In re Candelario Padilla*.¹⁴

Reg BI Guidance from FINRA’s Examination and Risk Monitoring Program. On February 9, 2022, FINRA published a 2022 Report on its Examination and Risk Monitoring Program, which presented FINRA’s findings with respect to firms’ implementation of Reg BI-related

obligations during the 2021 calendar year.¹⁵ In that report, FINRA highlighted some shortcomings that it identified through the course of its exams, which are worth reviewing for insight into how FINRA and other regulators might identify and understand Reg BI violations.¹⁶

First, FINRA’s Department of Member Supervision determined that several firms’ written supervisory procedures (“WSPs”) were not “reasonably designed to achieve compliance with Reg BI.”¹⁷ Specifically, FINRA found that certain WSPs provided “insufficiently precise guidance,” because they did not identify the individuals responsible for supervising Reg BI compliance, or because they failed to explain how the firm would comply with Reg BI beyond simply stating the rule’s requirements.¹⁸ FINRA also found that firms had “fail[ed] to modify existing policies and procedures to reflect Reg BI’s requirements by not addressing how costs and reasonably available alternatives should be considered when making recommendations, not addressing recommendations of account types, not addressing conflicts that create an incentive for associated persons to place their interest ahead of those of their customers, and not including provisions to address Reg BI-related recordkeeping obligations and the testing of the firms’ Reg BI and Form CRS policies, procedures, and controls.”¹⁹ Finally, FINRA determined that certain firms’ WSPs failed to describe adequate controls, either because such controls had not been developed or had not been memorialized.²⁰

Second, FINRA determined that several firms had failed to adequately train their associated persons on the requirements of Reg BI.²¹ Some firms did not provide any initial Reg BI training before the June 30, 2020 compliance date. Other firms provided training, but did not make clear Reg BI’s new obligations beyond the prior suitability obligations.²² Finally, FINRA found that some firms provided training that focused on Reg BI requirements, but the training was inadequate, because it

¹⁴ FINRA, *2022 Report on FINRA’s Examination and Risk Monitoring Program* (Feb. 9, 2022), <https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program>; Complaint, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022); *In re Malico*, FINRA AWC No. 2021069405501 (Oct. 11, 2022); *In re Cirella*, FINRA AWC No. 2020065683301 (Jan. 31, 2023); *In re Short*, FINRA AWC No. 2020065683302 (Jan. 31, 2023); *In re Long Island Financial Group, Inc.*, FINRA AWC No. 2021069365001 (Feb. 10, 2023); *In re Candelario Padilla*, FINRA AWC No. 2021071134401 (Mar. 10, 2023). In addition, the SEC released two Staff Bulletins in 2022 that provided guidance on the applicable standards of conduct for broker-dealers and investment advisers when making account recommendations and addressing conflicts of interest; this included important guidance on Reg BI’s requirements. SEC, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest* (Aug. 3, 2022), <https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest>; SEC, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors* (March 30, 2022), <https://www.sec.gov/tm/iabd-staff-bulletin>. FINRA’s Department of Member Supervision also released its *2023 Report on FINRA’s Examination and Risk Monitoring Program*, which presented FINRA’s findings with respect to Reg BI compliance during the 2022 calendar year. FINRA, *2023 Report on FINRA’s Examination and Risk Monitoring Program* (Jan. 10, 2023), <https://www.finra.org/rules-guidance/guidance/reports/2023-finras-examination-and-risk-monitoring-program>. Moreover, the SEC Division of Examinations released a Risk Alert on January 30, 2023 to “highlight deficiencies noted during examinations conducted, as well as weak practices that could result in deficiencies” with respect to broker-dealer compliance with Reg BI. SEC Division of Examinations, *Observations from Broker-Dealer Examinations Related to Regulation Best Interest* (Jan. 30, 2023), <https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf>. Practitioners and broker-dealers should be aware of, and would be wise to review, the guidance contained in the SEC Staff Bulletins, the SEC Division of Examinations Risk Alert, and the 2023 FINRA Report. For purposes of manageability, however, the authors have chosen not to summarize that guidance herein.

¹⁵ *2022 Report on FINRA’s Examination and Risk Monitoring Program*, *supra* note 14.

¹⁶ *Id.* at 24.

¹⁷ *Id.* at 26.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

“did not address the specific steps associated persons should take to comply with these requirements.”²³

Third, FINRA noted that some firms had failed to comply with Reg BI’s Care Obligation by “making recommendations that were not in the best interest of a particular retail customer based on that retail customer’s investment profile and potential risks, rewards and costs associated with the recommendation.”²⁴ Others violated the Care Obligation by “recommending a series of transactions that were excessive in light of a retail customer’s investment profile and placing the broker-dealer’s or associated person’s interest ahead of those retail customers.”²⁵

Fourth, FINRA identified that firms failed to comply with the Conflict of Interest Obligation by “not identifying conflicts or, if identified, not adequately addressing those conflicts.”²⁶

Fifth, FINRA found that certain firms were improperly using the terms “advisor” or “adviser.”²⁷ In these instances, associated persons, firms, or both were using the terms “advisor” or “adviser” in their titles or firm names, despite not being registered as an investment adviser.²⁸

Finally, FINRA determined that certain firms provided customers with “insufficient Reg BI disclosures.”²⁹ Specifically, such firms did not give customers “full and fair” disclosure of “all material facts related to the scope and terms of their relationship or related to conflicts of interest.”³⁰ Those material facts included commissions and fees received because of recommendations made. They also included potential conflicts of interest, such as “associated persons trading in the same securities in their personal accounts or outside employment.” They also included “material limitations in securities offerings.”³¹

The SEC’s First Reg BI Complaint. The SEC filed its first Reg BI-related complaint on June 15, 2022, in the U.S. District Court for the Central District of California.³² Although the matter is still pending, the allegations contained in the complaint offer additional insight into how the SEC identifies and understands Reg BI violations, particularly with respect to the Care and Compliance Obligations.

As a matter of background, defendants Western International Securities and five of its registered representatives, recommended to retail customers that they “purchase an unrated debt security, known as an L Bond.”³³ In connection with such recommendations, the SEC alleged that Defendants violated the Care Obligation and the Compliance Obligation of Reg BI.³⁴

The SEC identified two aspects of the defendants’ conduct alleged to have violated the Care Obligation.³⁵ First, the SEC alleged that the defendants failed to understand the risks associated with the recommendation of L Bonds.³⁶ The SEC noted that the Care Obligation requires broker-dealers to “exercise reasonable diligence, care, and skill to understand the potential risks, rewards, and costs associated with [a] recommendation.”³⁷ Yet, the SEC alleged, defendants did not understand the risks underlying L Bond transactions when they recommended them to retail customers.³⁸ Second, the SEC alleged that defendants recommended transactions without reasonable bases to believe the recommendations were in the best interest of the customer.³⁹ The SEC noted that the Care Obligation requires a broker-dealer to “exercise reasonable

²³ *Id.*

²⁴ *Id.* at 27.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² Complaint, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022); see also Order Grant. in Part Den. in Part Pl.’s Mot. to Strike Affirm. Defenses, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022).

³³ *Id.* An L Bond, created and offered by GWG Holdings, Inc., is “an unrated life insurance bond that finances the purchase and premium payments of life insurance contracts bought in the secondary market.” *L Bond*, CORP. FIN. INST. (Oct. 16, 2022); see also Complaint at 6–7, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022).

³⁴ Complaint, *S.E.C. v. W. Int’l Sec., Inc.*, No. 2:22-cv-04119 (C.D. Cal. 2022).

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 3–4.

diligence, care, and skill to have a reasonable basis to believe the recommendation is in the best interest of that customer, based on the customer's investment profile and the potential, risks, rewards, and costs associated with that recommendation."⁴⁰ Defendants had recommended L Bond transactions to seven customers that had investment profiles defined by moderate-conservative or moderate risk tolerances, among other indicators that the SEC alleged would suggest L Bond transactions were not in the customers' best interest.⁴¹

With respect to the Compliance Obligation, the SEC focused on defendants' written policies and procedures as the source of the alleged violation.⁴² The SEC noted that the Compliance Obligation mandates that broker-dealers "establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI."⁴³ Defendants' written policies and procedures, the SEC alleged, "merely recited the objectives of Reg BI, without offering registered representatives specific guidance tailored to Western's operations."⁴⁴ Moreover, the SEC contended that they did not contain adequate enforcement procedures for the few policies Western did have in place to further compliance with the Care Obligation.⁴⁵ As such, defendants' written policies and procedures were not "reasonably designed to achieve compliance with Reg BI's Care Obligation."⁴⁶

FINRA's First Reg BI Enforcement Actions. FINRA also brought its first Reg BI-related disciplinary actions in 2022 and 2023.⁴⁷ The first disciplinary action of the group, *In re Malico*, FINRA AWC No. 2021069405501 (Oct. 11, 2022), sheds light on how FINRA contemplates violations of Reg BI's Care Obligation,

particularly in the context of excessive trading.⁴⁸ Moreover, since FINRA became aware of Malico's conduct upon reviewing a customer-initiated arbitration, it demonstrates that FINRA enforcement may in certain cases be an additional consequence of the above-discussed uptick in Reg BI customer arbitrations.⁴⁹

As a matter of background, defendant Charles Malico, was a general securities representative, previously associated with Network 1 Financial Securities, Inc., who recommended that a single retail customer make more than 350 trades in his account.⁵⁰ While the customer's average account balance in the relevant period was less than \$30,000, such trading required the customer to pay more than \$54,000 in commissions and trading costs.⁵¹ FINRA determined that Malico's trading recommendations with respect to this customer were excessive and therefore violated the Care Obligation of Reg BI.⁵² Ultimately, Malico consented to a six-month suspension from associating with any FINRA member in all capacities and to a \$5,000 fine.⁵³

In explaining when trading is excessive for purposes of the Care Obligation, FINRA noted in the Letter of Acceptance, Waiver, and Consent ("AWC") that "no single test defines when trading is excessive, but factors such as the turnover rate, the cost-to-equity ratio, and the use of in-and-out trading in a customer's account are relevant."⁵⁴ FINRA indicated that, generally, a turnover rate of six, or a cost-to-equity ratio above 20 percent, suggests that trading activity is excessive.⁵⁵ Moreover, FINRA noted that a pattern of in-and-out trading, which is the practice of buying and selling the securities multiple times in a short period of time, would suggest excessive trading.⁵⁶

⁴⁰ *Id.*

⁴¹ *Id.* at 4.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *In re Malico*, FINRA AWC No. 2021069405501 (Oct. 11, 2022); *In re Cirella*, FINRA AWC No. 2020065683301 (Jan. 31, 2023); *In re Short*, FINRA AWC No. 2020065683302 (Jan. 31, 2023); *In re Long Island Financial Group, Inc.*, FINRA AWC No. 2021069365001 (Feb. 10, 2023); *In re Candelario Padilla*, FINRA AWC No. 2021071134401 (Mar. 10, 2023).

⁴⁸ *In re Malico*, FINRA AWC No. 2021069405501 (Oct. 11, 2022).

⁴⁹ *Id.* at 2.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.* at 3. FINRA did not require Malico to pay restitution to the customer, because the customer was already compensated as a result of a customer arbitration settlement with Network 1. *Id.* at 3 n.2.

⁵⁴ *Id.* at 2.

⁵⁵ *Id.*

⁵⁶ *Id.*

Since *Malico*, FINRA has brought two additional Reg BI-related disciplinary actions that also involved findings of excessive trading and violations of the Care Obligation: *In re Cirella*, FINRA AWC No. 2020065683301 (Jan. 31, 2023) and *In re Short*, FINRA AWC No. 2020065683302 (Jan. 31, 2023).⁵⁷ In the two unrelated actions, FINRA determined that the respondents had each violated the Care Obligation of Reg BI when they recommended a series of trading in a customer's account that FINRA determined to be excessive.⁵⁸ Echoing the *Malico* AWC, FINRA explained that although no one test determines whether trading recommendations are excessive, the turnover rate and the cost-to-equity ratio are key considerations.⁵⁹ Ultimately, *Cirella* consented to a three-month suspension from associating with any FINRA member in all capacities, a \$5,000 fine, and restitution of \$27,566 plus interest.⁶⁰ *Short* consented to a seven-month suspension from associating with any FINRA member in all capacities, a \$5,000 fine, and restitution of \$116,859 plus interest.⁶¹

FINRA also brought a Reg BI-related disciplinary action that involved violations of the Compliance and Conflict of Interest Obligations: *In re Long Island Financial Group, Inc.*, FINRA AWC No. 2021069365001 (Feb. 10, 2023).⁶² In the *Long Island Financial Group* AWC, FINRA explained that the Compliance Obligation of Reg BI "requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI."⁶³ Moreover, FINRA noted that the Conflict of Interest Obligation "requires broker-dealers to establish, maintain, and enforce written policies and procedures addressing conflicts of interest, defined as interests that might incline a broker-dealer or

an associated person — consciously or unconsciously — to make a recommendation that is not disinterested."⁶⁴

FINRA determined that Long Island Financial Group's written policies and procedures did not "make any reference to Reg BI" from June 30, 2020 to November 1, 2021.⁶⁵ Moreover, FINRA determined that although Long Island Financial Group's written policies and procedures beginning on November 1, 2021 contained "general background information about Reg BI," they did not contain procedures designed to "prevent, detect, or promptly correct violations of Reg BI or to otherwise achieve compliance with Reg BI."⁶⁶ Accordingly, Long Island Financial Group violated the Care Obligation and the Conflict of Interest Obligation of Reg BI.⁶⁷ Ultimately, Long Island Financial Group consented to a censure and a \$35,000 fine.⁶⁸

Finally, FINRA brought a Reg BI-related disciplinary action that involved complex product recommendations and a resulting violation of the Care Obligation: *In re Candelario Padilla*, FINRA AWC No. 2021071134401 (Mar. 10, 2023).⁶⁹ As a matter of background, Candelario Padilla was a general securities representative, associated with Nationwide Planning Associates, Inc., who recommended that certain retail customers purchase leveraged and inverse exchange-traded funds ("NT-ETFs").⁷⁰ FINRA determined that Candelario Padilla did not understand the risks and features of NT-ETFs — in particular, that losses in NT-ETFs can be compounded due to their "daily reset function."⁷¹ Accordingly, FINRA determined that

⁵⁷ *In re Cirella*, FINRA AWC No. 2020065683301 (Jan. 31, 2023); *In re Short*, FINRA AWC No. 2020065683302 (Jan. 31, 2023).

⁵⁸ *In re Cirella*, FINRA AWC No. 2020065683301, at 1–3; *In re Short*, FINRA AWC No. 2020065683302, at 1–3.

⁵⁹ *In re Cirella*, FINRA AWC No. 2020065683301, at 2; *In re Short*, FINRA AWC No. 2020065683302, at 1–3; *see also In re Malico*, FINRA AWC No. 2021069405501, at 2.

⁶⁰ *In re Cirella*, FINRA AWC No. 2020065683301, at 3.

⁶¹ *In re Short*, FINRA AWC No. 2020065683302, at 3.

⁶² *In re Long Island Financial Group, Inc.*, FINRA AWC No. 2021069365001 (Feb. 10, 2023).

⁶³ *Id.* at 2.

⁶⁴ *Id.*

⁶⁵ *Id.* at 1–3.

⁶⁶ *Id.* at 3.

⁶⁷ *Id.* at 2–3.

⁶⁸ *Id.* at 3.

⁶⁹ *In re Candelario Padilla*, FINRA AWC No. 2021071134401 (Mar. 10, 2023).

⁷⁰ *Id.*

⁷¹ *Id.* at 2–3. Regarding the risks and features associated with NT-ETFs, FINRA explained:

NT-ETFs are designed to return a multiple of an underlying index or benchmark, the inverse of that benchmark, or both, over only the course of one trading session — usually a single day. NT-ETFs typically rebalance their portfolios on a daily basis (also known as the daily reset). As a result, due to the effects of compounding daily returns during the holding period, the performance of NT-ETFs over periods longer than a single trading session can differ significantly from the

Candelario Padilla did not have a reasonable basis to recommend NT-ETFs to customers, and therefore, violated the Care Obligation of Reg BI.⁷² Ultimately, Candelario Padilla consented to a three-month suspension from associating with any FINRA member in all capacities, a \$2,500 fine, and restitution of \$26,422 plus interest.⁷³

CONCLUSIONS AND BEST PRACTICES

In conclusion, after a period of inactivity, Reg BI has now emerged in 2022 and 2023 as an active tool for customers of broker dealers — vis-à-vis customer arbitrations — and regulators — vis-à-vis exams and enforcement — to target alleged broker-dealer misconduct. It is essential for firms and practitioners to remain apprised of Reg BI arbitration and enforcement developments so as to inform tangible best practices. Although we can expect to learn more about the contours of Reg BI as the body of arbitration awards and SEC and FINRA enforcement decisions grows and develops, there are some best practices to take note of, even at this early stage.

First, an important lesson from FINRA's 2022 Report on Examination and Risk Monitoring, the SEC's *Western International Securities* complaint, and the *Long Island Financial Group* AWC is that the Compliance Obligation of Reg BI requires written supervisory procedures to contain meaningful, specific guidance on complying with the Care Obligation of Reg BI. Regulators can be expected to take the position that WSPs that do not address Reg BI or merely recite the requirements of Reg BI may be inadequate for purposes of the Compliance Obligation. Second, a lesson from a synthesis of the *Western International Securities* complaint and the *Malico, Cirella, Short, and Candelario Padilla* AWCs is that the Care Obligation requires broker-dealers to both develop a sophisticated understanding of the risks and characteristics of the products and strategies they recommend, and also carefully evaluate the risks of products and of those strategies against the customer's investor profile and risk tolerance. Regulators can be expected to take the position that a broker-dealer that does not understand the

risks of a product or strategy, recommends a product or strategy with risks or complexities that do not fit the customer's investor profile, or both, may be in violation of the Care Obligation.

Additionally, FINRA's 2022 Report on Examination and Risk Monitoring Program offers the following guidance for firms looking to avoid Reg BI violations that might serve as a useful supplement.⁷⁴ First, FINRA recommends that firms identify and mitigate conflicts of interest by creating and implementing tailored, business-specific policies and procedures, sampling transactions to monitor the consideration of reasonably available alternatives, and providing concrete resources to associated persons to guide the evaluation of reasonably available alternatives.⁷⁵ Second, FINRA recommends that firms limit high-risk or complex investments for retail customers that might not be in the customers' best interest by implementing product review processes that delineate product complexity and risk levels, limiting such recommendations to certain customers, and applying heightened supervision to such recommendations.⁷⁶ Finally, FINRA recommends that firms implement new processes for monitoring Reg BI compliance, including conducting monthly reviews of recommendations to ensure they conform to the Care Obligation.⁷⁷

In closing, firms and practitioners should expect to see, and are wise to monitor for, continued development surrounding Reg BI in both the arbitration and enforcement spaces. With that continued development, the nuances of the new standard are likely to become more clear. ■

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performance of their underlying index or benchmark during the same period of time.

Id. at 2.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ 2022 Report on FINRA's Examination and Risk Monitoring Program, *supra* note 14 at 28.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at 29.