Regulation Best Interest:

6 Must-Haves for Compliance

Reg BI is the biggest change to suitability regulations in 20 years – and it's right around the corner.
Is your firm ready?

Reg BI: Raising the Standard for Broker-Dealers

In a watershed moment, the U.S. Securities and Exchanges Commission voted on June 5, 2019 to pass Regulation Best Interest (also known as Regulation BI or Reg BI). The regulation, which is scheduled to take full effect on June 30, 2020, goes beyond existing suitability regulations to raise the standard of conduct for U.S. broker-dealers. Fundamentally altering the investor protection process, Reg BI requires broker-dealers to act in the "best interest" of their retail customers.

As a multi-faceted U.S. regulation, Reg BI imposes a number of obligations on broker-dealers. Under the new regulation, broker-dealers will need to:

1. Provide timely disclosures to retail clients;
2. Exercise diligence (care) in making investment recommendations in line with each client's best interest;
3. Mitigate or avoid conflicts of interest;
4. Maintain and enforce compliance procedures

Here are more specifics related to each obligation.

Best Interest Obligation

Disclosure Obligation	Care Obligation
Conflict of Interest Obligation	Compliance Obligation

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Disclosure Obligation

Under Reg BI, before or at the time of making a recommendation to a retail customer, broker-dealers must disclose material facts to help clients determine if a specific recommendation is in their best interest. This includes disclosing:

1. That the broker-dealer is acting as a broker, dealer, or an associated person of a broker or dealer with respect to the recommendation;
2. The material fees and costs that apply to the retail customer's transactions, holdings, and accounts;
3. The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer;
4. All material facts relating to conflicts of interest that are associated with the recommendation.

Care Obligation

Under Reg BI, broker-dealers must also exercise reasonable diligence, care, and skill in making recommendations to their retail customers, and recommendations must be in the client's best interest based on corresponding risks, rewards and costs, taking the client's investment profile into account.

Whether recommending a single or series of transactions, broker-dealers must have a reasonable basis to believe that these recommendations are in the client's best interest. Also, broker-dealers cannot place their own interests above their customers (meaning they cannot unduly benefit from recommendations at their clients' expense).

Compliance Obligation

Finally, under Reg BI's Compliance Obligation, firms must establish and enforce processes and procedures to ensure their compliance with Reg BI.

Conflict of Interest Obligation

To avoid conflicts of interest, broker-dealers must establish, maintain, and enforce written policies and procedures to:

1. Identify (and at a minimum disclose or eliminate) conflicts of interest associated with recommendations;
2. Identify and mitigate conflicts of interest (associated with recommendations) that create an incentive for broker-dealers to place their interests ahead of retail customers;
3. Prevent broker-dealers from recommending securities (with material limitations) that benefit the dealer at the expense of the customer, and;
4. Identify and eliminate sales contests, quotas, bonuses, and compensation that incentivize broker-dealers to sell specific securities.

Complying with Reg BI: Not Easy with Existing Technology

If your firm is just starting to consider how to comply with Reg BI, you're probably wondering how you'll be able to address your obligations with existing technology. The answer is – it won't be easy.

Your firm will have to monitor all broker-dealer communications through the lens of Reg BI. This will place an enormous compliance burden on your firm that will be difficult to overcome with manual processes and disjointed technologies.

For example, complying with the disclosure, care and compliance obligations of Reg BI really boils down to answering these key questions. How will your firm:

1. Identify recommendations made by broker-dealers?
2. Identify disclosures, both verbally and in written form, and determine whether those disclosures were timely and adequate?
3. Identify recommendations that were not in your clients' best interest?
4. Establish and enforce processes and procedures to ensure its compliance with Reg BI?

Given the current technology landscape of most broker-dealer firms, addressing these questions will be very problematic. Here's why:
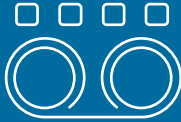
Lack of Voice Recording Leaves Gaps

Lexicon-based Surveillance Solutions Come up Short

No Out-of-the-box Analytics for 'Client Best Interest'

Disjointed Solutions Complicate Reg BI Compliance

Enforcing Processes and Procedures

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Lack of Voice Recording Leaves Gaps

In virtually every major regulatory enforcement action and prosecutorial lawsuit in recent memory, the smoking gun was found in communications. Under the U.S. books and records regulations (e.g. SEC Rules 17a-3 and 17a-4) broker-dealers are required to retain electronic communications (emails, instant messages), but there is no similar rule that mandates the recording of broker-dealer telephone conversations. If your firm isn't recording all regulated employee communications, including voice, recommendations and disclosures made in this manner will slip through the cracks.

"One of the challenges firms face is that many conversations do take place verbally, and if you're not capturing those phone calls, it will be very difficult to comply with Reg BI because you don't have the proper coverage," said Steve LoGalbo, NICE Actimize's Director of Communication Surveillance Product Management.

Lexicon-based Surveillance Solutions Come up Short

Many firms employ lexicon-based surveillance solutions to review electronic communications. While these types of solutions may be suitable for meeting obligations under FINRA, they won't stand up to the requirements of Reg BI. Because lexicon-based solutions are focused on finding words rather than understanding the true context of communications, they are highly imprecise and ineffective. This method of identifying disclosures and recommendations will not only increase risk, it will also inflate the cost of compliance because analysts will waste a lot of time chasing false positives and reviewing alerts that could otherwise have been weeded out by a more intelligent system. There's also no easy way to link disclosures to recommendations.

Finally, primitive lexicon-based systems also never 'learn' from their mistakes. "What tends to happen with these older systems is the compliance analyst reviews all the irrelevant false positives, but the system never learns from it," LoGalbo added. "Each day, the analyst is still wasting time reviewing more of the same types of irrelevant communications."

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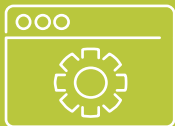
## No Out-of-the-box Analytics for 'Client Best Interest'

The over-arching mandate of Reg BI requires that broker-dealers act in the best interest of their retail customers when making recommendations, weighing the client's investment profile along with corresponding risks, rewards and costs. Whether recommending a single transaction or series of transactions, broker-dealers must focus on the client's best interest and not place their own interests above their client. As one can imagine, analyzing every single broker-dealer recommendation to determine whether they meet this 'best interest test' would be an immense undertaking. Firms need out-of-the-box analytics to simplify and streamline this process, and reduce false positive results, so they can meet their obligations under the new regulation.

Disjointed Solutions Complicate Reg BI Compliance

Voice and eComms recording, communications surveillance, sales practices and suitability surveillance – even if your firm has pieces of the technology puzzle needed for Reg BI compliance – if they were purchased separately from different companies, they probably won't work well together. Why does this matter? Imagine your broker-dealers use multiple channels to communicate but you record and surveil these communications in separate systems. Now imagine your trade data is in a different place too. Now consider that you need to analyze broker-dealer recommendations using analytics and data in still another system.

By its very nature, Reg BI requires the ability to link and analyze different pieces of information. Disjointed legacy systems will add unnecessary manual steps and layers of complexity, confusion and cost to Reg BI compliance, not to mention obscure the big picture view.
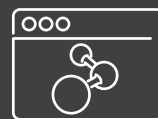
Enforcing Processes and Procedures

As your firm establishes processes and procedures to ensure compliance with Reg BI, how will you ensure they're followed? This requirement can be best addressed through process-driven technology, notably case management solutions, which many firms also lack today.

Reg BI: Why the New Regulation Requires a New Approach

Reg BI is the most significant change to suitability regulations in the United States in the past twenty years. If your firm is one of many still relying on outdated, legacy technology, now is the time for a new approach. As you embark on your search for a Reg BI solution, we encourage you to look for a comprehensive turnkey platform that combines the 6 essential capabilities and features below.

1 Integrated Voice Recording

Voice recording might not have been required before, but it's practically a must-have now. If your broker-dealers use voice channels to communicate with clients, make sure whatever comprehensive platform you choose for Reg BI compliance can also reliably record voice calls. It's the only practical way to absolutely prove what someone said.

2 Single Platform for Monitoring All Broker-Dealer Communications Across All Channels

Your broker-dealers use multiple modalities to communicate; your Reg BI solution needs to address all of these channels too. Many legacy solutions only monitor emails, limiting an analyst's ability to link and analyze all recommendations and disclosures. Look for an open, agnostic solution that provides a single platform for monitoring 100% of broker-dealer communications across all channels, including email (with or without attachments), and voice.

3 Intelligent Analytics Trump Lexicons Every Time

Look for a solution that incorporates intelligent analytics (fine-tuned for Reg BI compliance) that is also powered by Natural Language Processing (NLP) and machine learning (ML). This advanced technology will trump lexicon-based solutions every time when it comes to comprehending the true context of conversations. Using NLP and ML, the solution should be able to monitor broker-dealer conversations across all types of communication modalities (voice, email and attachments), and automatically identify recommendation conversations, while also analyzing prior communications to determine if proper disclosures were made (whether verbally, in writing or as attachments). Look for a solution that can analyze communications for signs of aggression, confusion or hesitation when discussing products – sure signs of risky behavior. The solution you select should also automatically flag, score and prioritize risky communications for further investigation.

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Out-of-the-box Analytics

Identifying recommendations is one thing – determining if they were in the client's best interest is entirely another. Make sure the solution you choose incorporates out-of-the box (OOTB) analytical models that can automatically detect prohibited sales practices and determine whether your broker-dealers are fulfilling their 'best interest' obligations under Reg BI. It also needs to factor in transaction risks, rewards, costs and other factors, along with the client's investment profile, to determine if a broker-dealer's recommendation (and/or transaction or series of transactions) are in the client's best interest, and automatically generate alerts if they're not. The most advanced solutions, such as NICE Actimize's Reg BI Surveillance, even incorporate a 'Best Product Alternative' analytics model which can analyze, highlight and display products that would have been more suitable for the broker-dealer to recommend, given a client's investor profile. You may also want to consider how easy it is to adapt the OOTB analytics to your firm's unique business processes. For example, you may want to extend the OOTB models to build additional checks into the system to identify broker-dealers with excessive alerts and put them under heightened supervision. Make sure the OOTB analytics can accommodate things like this, without the need for expensive and time-consuming custom development and programming.

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All-in-one Turnkey Platform

As noted previously, disjointed solutions add unnecessary manual steps and layers of complexity, confusion and cost to Reg BI compliance, while obscuring the big picture view. Make sure the solution you choose is holistic – meaning it integrates all the capabilities you need (e.g. recording, communications surveillance, trade surveillance, sales practices and suitability surveillance, and case management - including the ability to analyze, correlate and pull back related structured and unstructured data, such as alerts, communications, trades, and results of analytics), **all-in-one turnkey platform**. Having a single, holistic platform will ensure your firm's compliance with Reg BI and reduce workloads, confusion and costs. By correlating trades and communications data in one system, firms can even go beyond the obligations of Reg BI to perform targeted reviews of orders for high risk products to ensure that proper disclosures were given.

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Case Management Capabilities

Under Reg BI's Compliance Obligation, it's not enough to simply establish processes and procedures to ensure compliance; you need to enforce them. Choose a solution with robust case management capabilities which can provide a foundation for standardizing procedures and ensuring they are followed. You'll want to be able to create standardized workflows to automate every stage of the investigation process. Furthermore, with the right case management tools, your analysts will have one place to manage all investigations and alerts (enriched with correlated alerts, communications and transaction data). You also want to make sure that all actions can be tracked and audited for compliance verification.

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About NICE Actimize

NICE Actimize is the largest and broadest provider of financial crime, risk and compliance solutions for regional and global financial institutions, as well as government regulators. Consistently ranked as number one in the space, NICE Actimize experts apply innovative technology to protect institutions and safeguard consumers and investors assets by identifying financial crime, preventing fraud and providing regulatory compliance. The company provides real-time, cross-channel fraud prevention, anti-money laundering detection, and trading surveillance solutions that address such concerns as payment fraud, cybercrime, sanctions monitoring, market abuse, customer due diligence and insider trading.

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