



Adapting to a shifting regulatory environment

UNDERSTAND THE LANDSCAPE AND BE POSITIONED FOR SUCCESS

The financial services industry has always been highly regulated – and rightfully so, given what’s at stake. In recent years, regulatory reform has intensified as more complex challenges arise and more emphasis is placed on protecting end clients as well as those who serve them.

Although the industry may consider today’s increased regulatory and compliance oversight to be a necessary but cumbersome aspect of conducting business, heightened regulatory measures are designed to benefit those who are willing to embrace them as a means of differentiating themselves from the competition. After all, since evolving regulations are primarily intended to safeguard investors and mitigate risk, getting on board with these regulatory initiatives could be a proof point that advisors and their firms offer value to clients and have their best interests in mind.

At BNY Mellon’s Pershing, we take a collaborative, consultative approach to helping you manage and grow your business. If you’re interested in regulatory issues like data protection, cybersecurity and fraud, we have explored each of them in individual whitepapers.

Although the aforementioned issues tend to garner significant attention and make headlines in mainstream and financial media alike, other important topics are also part of the trend toward improved regulation and protection. They include, but are not limited to, the following:

- Regulation Best Interest (Reg BI)
- Form CRS, the new client relationship summary
- Financial abuse of seniors/elders



These three topics are highly relevant to Security and Exchange Commission (SEC) registered investment advisers (RIAs) who work with retail investors, and broker-dealers registered with the Financial Industry Regulatory Authority (FINRA).



Reg BI: A Higher Level of Client Care

The SEC states that Reg BI is a standard of conduct for broker-dealers whenever they make a securities recommendation to retail investor clients. Reg BI goes beyond traditional suitability obligations. It aligns conduct standards with retail clients' reasonable expectations by requiring broker-dealers to act in the best interest of these clients, rather than their own. If a conflict of interest is not reasonably addressed by a full disclosure of material facts, the broker-dealer must take actions that can mitigate or eliminate this conflict.

One of the practical applications of Reg BI involves share classes of mutual funds. For instance, when considering Class A, B or C shares, it's clear that each class has a different fee structure and their suitability depends on a retail investor's particular financial and time-horizon circumstances. Under Reg BI, the broker-dealer must invest the retail client's assets in the share class that's most beneficial for this specific client, regardless of the impact on the broker-dealer's compensation.

Such a requirement involves "regular monitoring of accounts and portfolios," says Michelle Logue, Pershing's Chief Compliance Officer. "You can have the lowest-cost share class today and next week that could change, which means ongoing administration and research are essential. Since the regulators may consider it a suitability issue or a potential risk-execution issue, it's something that broker-dealers need to focus on to ensure the client's best interests are met."

While the goal is always to eliminate conflicts of interest, it is not always possible. In such cases, the risk either needs to be mitigated or fully disclosed. Given that it's extremely difficult to anticipate whether or not the regulators will be satisfied with particular mitigation or disclosure efforts, the most practical course of action is to be as transparent as possible and always do what's best for the client.

Another significant challenge pertaining to Reg BI is that certain states are introducing different rules. For instance, Massachusetts, through its Fiduciary Rule, has recently enacted a requirement for sales content (to be enforced starting September 1, 2020) that is an amendment of Reg BI. This means that traditional broker-dealers who produce sales content directed at retail clients in different states will need to be mindful of the variances regarding standard of care. In the case of Massachusetts, the standards are more rigorous than Reg BI and stipulate that disclosure alone is not sufficient. Every reasonable effort must be made to avoid conflict of interest; if unavoidable, then the conflict must be mitigated or eliminated. Other states may eventually proffer their own interpretations of Reg BI, potentially leading to a fragmented regulatory environment.



Form CRS: Enabling apples-to-apples comparisons

The SEC requires registered investment advisers, registered broker-dealers and dually registered firms to provide an easy-to-understand client relationship summary (Form CRS) to retail investors. For single registrants, the summary cannot exceed two pages, while the limit is four pages for dual registrants.

The intent of this concise, plain-language summary is to inform retail investors about the various types of client relationships and services that the firm offers, as well as the costs, standard of conduct and potential conflicts of interest related to these relationships and services. Also included under Form CRS is a declaration of whether the firm and its financial professionals have any reportable legal or disciplinary history, as well as explicit direction to investor education resources related to investment advisers, broker-dealers and financial professionals. Retail clients will receive Form CRS at the start of their relationship with a given firm, as well as updated information should there be any relevant material changes. Form CRS allows investors (i.e., potential clients) to easily compare relationships and services of different firms, helping them decide with which firm they wish to conduct business.

If you require assistance regarding Form CRS, Pershing has created two documents to help you:

- Getting Started with Form CRS provides a checklist and considerations for content, processes, delivery and recordkeeping.
- Client Guide for SEC Client Relationship Summary (Form CRS) offers practical guidance, section by section, on how to produce a robust, comprehensive Form CRS.



Addressing Elder Abuse in the Industry

Another major regulatory focus in recent years has been on the protection of seniors and vulnerable adults against fraud or otherwise being financially mistreated by industry professionals.

“Everyone is aware of this topic and it has broad relevance for the industry and its regulatory bodies. We spend considerable time educating advisors on current schemes and frauds. It’s heartbreaking to see trusting, vulnerable seniors being taken advantage of in any manner.”

*-Joan Schwartz
Chief Legal Officer, BNY Mellon’s Pershing*



A recent FINRA proposal seeks to prevent registered representatives (non RIAs) from acting as beneficiaries on certain accounts belonging to seniors. Some people in the advisory space exert undue influence on elderly clients and become so close with them that they eventually take on positions – like an executor, trustee or administrator of an estate – and then the client chooses to gift assets to them upon their passing, which becomes an obvious conflict of interest. Unfortunately, as the U.S. population continues to age, the industry should expect more of these issues to surface.

Elder abuse remains a major concern as it ties into the trust of the investing public. The industry bears much responsibility for providing the services required to save for education (e.g., helping to send children/grandchildren to college), retirement and all of life's needs. It would be prudent for advisors and their organizations to take a firm, proactive approach to avoiding or mitigating risks associated with seniors and their financial wellbeing.



RegTech Can Help Facilitate Compliance

In order for advisors to securely monitor and manage regulatory processes, regulatory technology tools (RegTech) may be a cost-effective solution. For instance, depending on the situation, Form CRS either has to be delivered at the time the recommendation is made or the time when the advisory agreement is signed. The financial industry as a whole must determine what is the optimal mechanism for delivery and come to a mutual agreement. From a RegTech perspective, electronic delivery of Form CRS would clearly help with the timing while also satisfying compliance requirements.

With regard to broker-dealers, Form CRS is complicated because not only must they deliver at the time of the recommendation, but if the retail investor never opens an account, the firm still has to document and retain the information for a period of time that the investor had been provided with a recommendation that constitutes part of the Form CRS requirement.

When implementing technology around the delivery of Form CRS, the key steps would include entering a form into the system, inputting the proper information and then delivering it. The advisor doesn't have to provide the documentation until the advisory agreement is signed. Given this timing, many advisors have elected to make Form CRS the first two pages of their advisory agreement. This way, they can demonstrate timely delivery and client signoffs, which helps simplify the compliance process.

RegTech may also be valuable from a regulatory and compliance perspective in terms of protecting sensitive information (via secure data storage and document encryption), employing system risk controls to help thwart hackers and maximizing the efficacy of digital signature technology.



Diverse Impacts of Regulatory Reform

The rollout of new regulations and compliance standards has illustrated how various industry members are affected differently. For instance, broker-dealers are now comprehending the finer points of the entire process. From their perspective, it's a different way of conducting business and involves a shift in mindset. If a client has a brokerage account, then their firm provided them with a Form CRS when they opened that account. But what if the client later decides they want to move to an RIA? Once the move has been completed, the client's account is tagged as "RIA" with an affiliated RIA of their broker-dealer. The move could result in the client having to receive another Form CRS. This duplication is just one of the many variables that everyone in the industry needs to consider and work out in an efficient, logical manner.



The financial industry is counting on regulators like the SEC and FINRA to provide strong guidance in terms of defining clear regulatory roles and responsibilities. This guidance would help firms that are presently not fully advisory to make smoother transitions and better understand what's expected of them as they attempt to refashion their business.

If an advisor is standalone and SEC registered, then Reg BI and Form CRS should have minimal impact. Although Form CRS is required as Part Three of the Form ADV and advisors must follow a standard template, for such firms these actions represent little more than a perfunctory obligation.

However, for firms like broker-dealers that are affiliated with advisors, it's a bigger task. Advisors with a broker-dealer connection likely don't have a Form ADV responsibility, so satisfying all of the Reg BI disclosure requirements is a significant undertaking. Yet, since Form CRS is limited to two pages and is formatted in a set template, meeting these new compliance standards becomes less onerous.

For the typical RIA, Reg BI likely won't be impactful because this regulation is largely focused on enhancing the duty and care standards in the broker-dealer segment. In terms of Form CRS, given that it's an add-on to their existing Form ADV, the primary concern for RIAs is to execute in a timely fashion. RIAs are more intent on implementing and maintaining strong controls on their technology to protect client information from privacy or cybersecurity breaches. One of their primary objectives is to gain the trust of the investing public and encourage them to pursue the benefits of fee-based advice.

It's important for RIAs to find an effective way to distinguish themselves as being entrenched in the true advice and planning business, where they can help clients with all their financial needs while committing to a higher (fiduciary) standard of care. RIAs holistically address a client's life, from investment strategies and tax planning to debt/liability management and more. It's important for RIAs to continue discussing the value they create for clients within the fee-for-service business model.



We're Here to Support You

At Pershing, we are resolutely focused on staying abreast of all regulatory matters and educating our clients. On behalf of both the regulators and the advisors on our platform, we work tirelessly to find and implement solutions that help them achieve compliance. We also hire experts to try and “poke holes” in our industry certifications. The overarching aim is to give advisors some comfort and peace of mind.

“Clients value our focus on key regulatory requirements and the strength and stability we provide as custodians. Since we service different business models the way they want to be serviced and connect our technology with other technology platforms, advisors can receive the comprehensive, tailored offering they need.”

*-Joan Schwartz
Chief Legal Officer, BNY Mellon's Pershing*

Custodians fulfill an important role in the industry by managing a significant portion of the regulatory burden – something most firms are not able to take on. Clearing firms like Pershing provide the investing public with many opportunities. The independent (i.e., third party) clearing model, which is distinct from the self-clearing approach, creates much greater choice, especially for smaller investors.

After all, not everybody has an account big enough to be serviced by the larger firms. Whether they're millennials, seniors or anyone in between, many people lack the capacity to earn and save enough money. Whatever they are earning, the industry wants to help them save as much as possible. Regardless of a given firm's business model, one of the industry's unifying aspects is that everyone genuinely wants to provide meaningful service and good value to the investing public, to help them reach their financial objectives. Accordingly, the entire industry is motivated to collaborate and exercise regulatory vigilance.

“We're at a pivotal time where the competitive walls must come down at times, especially from a regulatory perspective, so we can all be on the same page” Pershing's Michelle Logue says. “We spend considerable time in various industry groups discussing regulatory issues and figuring out what's best for the client and the industry. We all take great pride in this common and worthy goal.”



Regulatory Resources

As part of our commitment to educating clients on important regulatory issues like Reg BI and Form CRS, Pershing offers downloadable presentation decks as well as webinar sessions where we can address your questions. For your reference and convenience, we also make available recent FAQs issued by the SEC on relevant regulatory matters.



Pershing

BNY Mellon's Pershing and its affiliates provide a comprehensive network of global financial business solutions to advisors, broker-dealers, family offices, hedge fund and 40 Act fund managers, registered investment advisor firms and wealth managers. Many of the world's most sophisticated and successful financial services firms rely on Pershing for clearing and custody; investment, wealth and retirement solutions; technology and enterprise data management; trading services; prime brokerage and business consulting. Pershing helps clients improve profitability and drive growth, create capacity and efficiency, attract and retain talent, and manage risk and regulation. With a network of offices worldwide, Pershing provides business-to-business solutions to clients representing approximately 7 million investor accounts globally. Pershing LLC (member FINRA, NYSE, SIPC) is a BNY Mellon company.

Important Legal Information—Please read the disclaimer before proceeding.

- Please read these terms and conditions carefully. By continuing any further, you agree to be bound by the terms and conditions described below.
- This paper has been designed for informational purposes only. The services and information referenced are for investment professional use only and not intended for personal individual use. Pershing LLC and its affiliates do not intend to provide investment advice through this paper and do not represent that the services discussed are suitable for any particular purpose. Pershing and its affiliates do not, and the information contained herein does not, intend to render tax or legal advice.

Warranty and limitation of liability

- The accuracy, completeness and timeliness of the information contained herein cannot be guaranteed. Pershing and its affiliates do not warranty, guarantee or make any representations, or make any implied or express warranty or assume any liability with regard to the use of the information contained herein.
- Pershing and its affiliates are not liable for any harm caused by the transmission, through accessing the services or information contained herein.
- Pershing and its affiliates have no duty, responsibility or obligation to update or correct any information contained herein.

©2020 Pershing LLC. Pershing LLC, member FINRA, NYSE, SIPC, is a subsidiary of The Bank of New York Mellon Corporation (BNY Mellon). Pershing does not provide investment advice. Affiliated investment advisory services, if offered, are provided by Lockwood Advisors, Inc. (Lockwood), a Pershing affiliate and an investment adviser registered in the United States under the Investment Advisers Act of 1940. For professional use only. Not intended for use by the general public. Trademark(s) belong to their respective owners.

[pershing.com](https://www.pershing.com)



One Pershing Plaza, Jersey City, NJ 07399

WP-PER-WT-01-20