

R.M. Stark & Co., Inc.

REGULATION BEST INTEREST

BACKGROUND

On June 5, 2019, the Securities and Exchange Commission (SEC) approved the Regulation Best Interest Package (Reg BI). The entire package is 1,363 pages. Reg BI upgrades the market conduct standard for brokers and their firms from an arms-length, suitability standard to a quasi-fiduciary, or “best interest” standard of conduct.

The Compliance deadline is June 30, 2020. The Regulation applies only to retail customers. Reg BI establishes a core “Best Interest” obligation and four subordinate obligations (or duties) of a broker-dealer (BD) and its registered representatives in providing investment recommendations or strategies to its retail customers.

BEST INTEREST OBLIGATION

1. The broker shall act in the best interest of the customer at the time a recommendation involving investment products, strategies, or account changes (*i.e.*, rollovers) is made, without placing the interests of the firm ahead of the customer.
2. The best interest obligation is satisfied by meeting the other four obligations listed below:

I. DISCLOSURE OBLIGATIONS

Prior to, or at time of recommendation, the broker shall provide “full and fair disclosure” of all material facts including:

1. Material fees and costs that apply to customer’s transactions, holdings, and accounts;
2. Type and scope of services provided, including material limitations on strategies that may be recommended; and,
3. All material facts related to conflicts of interest associated with the recommendation.

Q: As a registered representative, are there circumstances where I can provide oral disclosures, or provide written disclosures after a recommendation is made, without violating the obligation under Regulation Best Interest to provide written disclosures “prior to, or at the time of the recommendation?”

Only in limited circumstances. Reg BI requires the broker, prior to, or at the time of the recommendation, to provide the retail customer, in writing, full and fair disclosure of all material facts relating to the scope and terms of the relationship with the retail customer and all material facts relating to conflicts of interest that are associated with the recommendation.

Q: Can I satisfy the Disclosure Obligation under Reg BI with my Customer Relationship Summary (Form CRS)?

Generally, no. Whether the Form CRS, or any existing disclosure, by itself, will satisfy the Disclosure Obligation in full would depend on the facts and circumstances. However, in most instances, you will need to provide additional information beyond the summary information contained in the Form CRS to satisfy the Disclosure Obligation.

Q: May I use the term “adviser” or “advisor” in my title?

Generally, no. The Commission presumes that the use of the term “adviser” or “advisor” in a name or title by broker that is not registered as an investment adviser is a violation of the requirement to disclose your broker capacity under Reg BI’s Disclosure Obligation.

II. CARE OBLIGATION

A broker exercises “reasonable diligence, care, and skill” in making the recommendation, including:

1. Understanding the potential risks, rewards and costs, and a reasonable basis to believe that recommendation could be in the best interest of at least some customers;
2. Have a reasonable basis to believe the recommendation is in the best interest of a retail customer based on the customer’s investment profile, and does not place the interests of the firm or broker ahead of the customer;
3. Have a reasonable basis to believe that a series of recommended transactions, even when viewing the customer’s best interest in isolation, is not excessive, and is in the investor’s best interest, taking into account the customer’s investment profile and does not place the firm/broker’s interest ahead of the customer.

Q: For purposes of the Care Obligation under Reg BI, what constitutes a “series of transactions,” and whether a particular transaction is part of a “series of transactions?”

A “series” of recommended transactions is an established term under the federal securities laws and SRO rules that is evaluated in concert with existing guideposts, such as turnover rate, cost-to-equity ratio, and use of in-and-out trading, which have been developed over time and which serve as indicators of excessive trading.

III. CONFLICT OF INTEREST OBLIGATION

The firm must establish, maintain, and enforce policies and procedures that:

1. Identify and, at a minimum, disclose or eliminate all conflicts of interest related to the recommendation;

2. Identify and mitigate conflicts that create an incentive for the broker to make recommendations that place the firm's interests ahead of the customer;
3. Identify and disclose material limitations placed on the investment product or strategy and any conflicts associated with such limitations;
4. Prevent these limitations from causing the broker to make recommendations that place the firm's interests ahead of the customer; and,
5. Identify and eliminate sales contests, sales quotas, bonuses, etc. that are based on:
 - a. a specific product; or,
 - b. types of securities within a limited period.

Q: Does Reg BI mandate any mitigation methods?

No. In lieu of mandating specific mitigation measures, or a "one-size fits all" approach, RMST has the flexibility to develop and tailor reasonably designed policies and procedures that include conflict mitigation measures based on our firm's circumstances.

The SEC provided the following non-exhaustive list of practices that could be used as potential mitigation methods for firms to comply:

1. avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
2. minimizing compensation incentives for employees to favor one type of account over another, or to favor one type of product over another (for example, proprietary or preferred provider products, or comparable products sold on a principal basis), by establishing differential compensation based on neutral factors;
3. eliminating compensation incentives within comparable product lines by, for example, capping the credit that an associated person may receive across mutual funds or other comparable products across providers;
4. implementing supervisory procedures to monitor recommendations that are: near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the roll-over or transfer of assets from one type of account to another (such as recommendations to roll-over, or transfer assets in an ERISA account to an IRA) or from one product class to another;
5. adjusting compensation for associated persons who fail to adequately manage conflicts of interest; and,
6. limiting the types of retail customer to whom a product, transaction, or strategy may be recommended.

IV. COMPLIANCE OBLIGATION

The Compliance Obligation requires that RMST establish, maintain, and enforce, written policies and procedures that are reasonably designed to achieve compliance with Regulation Best Interest.

Q: Is RMST required to build new systems of controls and compliance to satisfy the Compliance Obligation?

Yes. All established written policies and procedures shall be completed, maintained, and enforced as of June 30, 2020.

FORM CRS (ATTACHED)

Q: What is Form CRS?

Form CRS is a client or customer relationship summary. We are required to deliver a relationship summary to prospects and customers beginning in July 2020. The relationship summary contains important information about RMST.

Q: Why should prospects and clients read the CRS?

Choosing or continuing to work with a financial professional is an important decision. Brokers offer different types of services and are paid differently. Reading a relationship summary can help your prospects and clients decide if the products and services offered by RMST is right for them.

Q: What information is in a relationship summary?

A relationship summary tells you about:

1. the types of services the firm offers;
2. the fees, costs, conflicts of interest, and required standard of conduct associated with those services;
3. whether the firm and its financial professionals have a reportable legal or disciplinary history; and,
4. how to get more information about the firm.

A relationship summary also includes questions to help your prospects and clients begin a discussion with you about the relationship, including your services, fees, costs, conflicts, and disciplinary information.

Q: When do I have to distribute a relationship summary?

Beginning July 1, 2020, you must provide a CRS when starting a relationship with a new prospect or client, and anytime you recommend account changes (*i.e.*, when you rollover an IRA).

Existing clients with assets held at Pershing will receive Form CRS in their June statement. Customers with assets held away are being mailed Form CRS at or about the same time.

Q: Is Form CRS the only Disclosure that I need to provide my clients and prospects?

No. It is the minimum required disclosure. For example, if you are recommending a CASH IRA account, you would need to provide the CRS, the R.M. Stark Customer Disclosure Booklet, and the IRA Plan, which includes fees and costs.

DEFINITIONS

Retail Customer

Q: How is a retail customer defined?

A retail customer is defined as “a natural person, or the legal representative of such natural person, who:

1. receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and,
2. uses the recommendation primarily for personal, family, or household purposes.”

Recommendation

Q. What does it mean to “use” a recommendation?

A retail customer “uses” a recommendation of a securities transaction or investment strategy involving securities when, because of the recommendation:

1. the retail customer opens a brokerage account with RMST, regardless of whether you receive compensation;
2. the retail customer has an existing account with RMST and receives a recommendation from the you, regardless of whether you receive or will receive compensation, directly or indirectly, because of that recommendation; or,
3. you receive or will receive compensation, directly or indirectly, because of that recommendation, even if that retail customer does not have an account at the firm (away accounts).

Note: When a retail customer opens or has an existing account with you, the retail customer has a relationship with RMST and is, therefore, in a position to “use” (*i.e.*, accept or reject) the recommendation.

Q: What account recommendations are covered by Reg BI?

Reg BI expressly applies to account recommendations, including recommendations of securities account types, generally (*i.e.*, whether to open an IRA or other brokerage account), as well as

recommendations to roll over or transfer assets from one type of account to another (*i.e.*, from a workplace retirement plan account to an IRA).

There are many options or account types offered by RMST. For example, accounts can include: education accounts (*i.e.*, 529 Plans and tax-free Coverdell accounts); retirement accounts (*i.e.*, IRA, Roth IRA, or SEP-IRA accounts); and, specialty accounts (*i.e.*, cash or margin accounts, and accounts with access to Forex or options trading). Different brokerage accounts can also offer different levels of services.

The type of securities account recommended is an investment strategy that has the potential to greatly affect a customers' costs and investment returns. For example, different types of securities accounts can offer different features, products, or services, some of which may - or may not - be in the best interest of certain retail customers. Accordingly, the SEC broadly interprets the term "investment strategy" (which includes account recommendations). Further, account recommendations will almost always involve a "securities transaction," (such as a securities purchase, sale, or exchange), and thus are subject to Reg BI.

Q: If I meet and talk with a prospective retail customer in an informal setting (*i.e.*, on the golf course, at social gatherings, or while running errands), is my communication (sometimes referred to as a "hire me" communication) subject to Reg BI?

Whether your communication is subject to Reg BI depends on whether you make a "recommendation," it does not on the location or setting of the communication.

Reg BI applies to a "recommendation of a securities transaction or investment strategy involving securities (including account recommendations) to a retail customer." Under this existing framework, a factor to consider is whether the communication "reasonably could be viewed as a 'call to action.'" The more individually tailored the communication is to a specific customer or a targeted group of customers, the greater the likelihood that the communication may be viewed as a "recommendation."

If you engage in a communication with a retail customer that rises to the level of a "recommendation," whether in the context of a "hire me" conversation or otherwise, the recommendation will be subject to Reg BI.

Not all communications with a prospective retail customer will rise to the level of a recommendation. For example, consider a scenario where you meet a prospective retail customer at a dinner party and say: "I have been working with our mutual friend, Bob, for fifteen years, helping him to invest for his kids' college tuition and for retirement. I would love to talk with you about the types of services my firm offers and how I could help you meet your goals. Here is my business card. Please give me a call on Monday so that we can discuss this."

Q: If I inform a retail customer that he or she may make a cash contribution to an IRA in an amount up to the annual IRS contribution limit, or if I make other educational communications about IRAs or other retirements accounts, are those communications subject to Reg BI?

Generally, no. While this answer will depend on the facts and circumstances of the communication, in the SEC's view, a communication such as informing a retail customer that he or she may make a cash contribution to an IRA in an amount up to the annual IRS contribution limit would not, by itself, rise to the level of a "recommendation."

Consistent with existing RMST regulation, certain communications are treated as "education," rather than "recommendations." For example, a general conversation about retirement planning, such as providing a company's retirement plan options to a retail customer, would not, by itself, rise to the level of a recommendation. Similarly, if you inform a retail customer that he or she needs to take a required minimum distribution under the Internal Revenue Code, the Commission stated that it would not interpret such communication, by itself, to rise to the level of a "recommendation." Such a communication would be considered investment education or descriptive information, provided, however, it does not involve, for example, a recommendation regarding specific securities to be sold or a recommendation regarding specific securities to be purchased with the proceeds of any sale.

Q: Does Reg BI apply to a recommendation to a retail customer to open a self-directed brokerage account, where subsequent recommendations will not be provided by the broker-dealer?

Yes. A recommendation of a securities account (here, a self-directed brokerage account) is covered by Reg BI - even if you do not intend to provide subsequent recommendations.

Q: Are there specific factors a broker-dealer should consider when making account type recommendations, or recommendations to open an IRA, or to roll over assets into an IRA?

1. With respect to account type recommendations, you should generally consider:
 - a. the services and products provided in the account;
 - b. the projected cost to the retail customer of the account;
 - c. alternative account types available;
 - d. the services requested by the retail customer; and,
 - e. the retail customer's investment profile.

2. When making recommendations to open an IRA, or to roll over assets into an IRA, you should consider a variety of factors, including, but not limited to:
 - a. fees and expenses;
 - b. level of services available;
 - c. available investment options;
 - d. ability to take penalty-free withdrawals;
 - e. application of required minimum distributions;
 - f. protections from creditors and legal judgments;
 - g. holdings of employer stock; and,
 - h. any special features of the existing account.

Q: Are there special considerations when broker-dealers recommend securities or investment strategies that are complex or risky?

When recommending securities or investment strategies that are complex, such as inverse or leveraged exchange-traded products, you should take particular care to make sure you understand the terms, features, and risks – as with the potential risks, rewards, and costs of any security or investment strategy – in order to establish a reasonable basis to recommend the product to retail customers. Further, you must weigh the potential risks, rewards, and costs of the product or investment strategy, considering the retail customer’s investment profile.

Thus, when recommending such products, you should understand that inverse and leveraged exchange-traded products that are reset daily may not be in the best interest of retail customers who plan to hold them for longer than one trading session, particularly in volatile markets. Further, these products may not be in the best interest of a retail customer absent an identified, short-term, customer-specific trading objective.

Similarly, when recommending potentially high-risk products, such as thinly traded securities, you should generally apply heightened scrutiny to whether such investments are in your retail customer’s best interest.

Q: Must I consider every possible alternative when making a recommendation?

You should consider reasonably available alternatives, if any, offered by RMST in determining whether you have a reasonable basis for making the recommendation.

This exercise would require you to conduct a review of such reasonably available alternatives that are reasonable under the circumstances, which will depend on the facts and circumstances at the time of the recommendation.

Monitoring

Q: What Special Considerations are there for Agreed-Upon Account Monitoring?

You may agree with a retail customer to take on additional obligations beyond those imposed by Regulation Best Interest. For example, you may agree with a retail customer to provide monitoring of your retail customer’s investments on a periodic basis for purposes of recommending changes in investments. When you agree with a retail customer to monitor that customer’s account:

- you are required to disclose the terms of such account monitoring services (including the scope and frequency of such services) pursuant to the Disclosure Obligation; and,
- such agreed-upon monitoring involves an implicit recommendation to hold (*i.e.*, recommendation not to buy, sell, or exchange assets pursuant to that securities account review) until the time the agreed-upon monitoring occurs.

Scope of monitoring: Reg BI does not impose a duty to monitor a retail customer's account. Absent an agreement with the customer, Reg BI does not prohibit you from monitoring the account if it is reasonably related to your primary business of effecting securities transactions.

If you agree with a retail customer to perform account monitoring services, you are taking on an obligation to review and make recommendations with respect to that account (i.e., to buy, sell or hold) on the specified, periodic basis that you have agreed to with the retail customer. For example, if you agree to monitor your retail customer's account on a quarterly basis, the quarterly review, and each resulting recommendation to purchase, sell, or hold will be a recommendation subject to Regulation Best Interest.

Implicit hold recommendations: If you agree to perform account monitoring services, then Regulation Best Interest applies even where you remain silent (i.e., an implicit hold recommendation).

Voluntary account review: You may voluntarily, and without any agreement with your customer, review the holdings in your retail customer's account for the purposes of determining whether to provide a recommendation to the customer. This voluntary review is not considered to be "account monitoring," nor would it create an implied agreement with the retail customer to monitor the customer's account.

Record Keeping

Q: What are the Record-Making and Recordkeeping Requirements?

In connection with Reg BI, you must meet new record-making and recordkeeping requirements with respect to information collected from, or provided to, retail customers. This builds upon existing record-making and recordkeeping obligations.

- For each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided, you must keep a record of all information collected from and provided to the retail customer pursuant to Reg BI.
- You must retain all records of the information collected from or provided to each retail customer for at least six years after the earlier of the date the account was closed or the date on which the information was replaced or updated.

Other Resources

The adopting release for Regulation Best Interest can be found on the Commission's website at <https://www.sec.gov/rules/final/2019/34-86031.pdf>

The adopting release for Form CRS Relationship Summary and Amendments to Form ADV can be found on the Commission's website at <https://www.sec.gov/rules/final/2019/34-86032.pdf>

The Form CRS Instructions can be found on the Commission's website at <https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf>

The Form ADV General Instructions can be found on the Commission's website at <https://www.sec.gov/rules/final/2019/34-86032-appendix-a.pdf>

The Commission Interpretation Regarding Standard of Conduct for Investment Advisers can be found on the Commission's website at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>

The Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser can be found on the Commission's website at <https://www.sec.gov/rules/interp/2019/ia-5249.pdf>.