FINRA Settles Its First Reg BI Action

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On September 28, 2022, FINRA settled its first formal action alleging violations of Regulation Best Interest, Rule 15l-1(a) under the Securities Exchange Act of 1934 (Reg BI).

In Charles v. Malico, the respondent consented to findings, without admitting or denying them, that he willfully violated the Best Interest Obligation under Reg BI by recommending a series of transactions in the account of a retail customer that was excessive in light of the customer's investment profile, and therefore was not in the customer's "best interest." Specifically, FINRA found that the respondent recommended that his customer make more than 350 trades in his account over a 17-month period, causing the customer to pay more than $54,000 in commissions, while losing more than $17,500 during the same period. Collectively, the trades resulted in an annualized cost-to-equity ratio exceeding 158%, meaning that the customer's account would have to grow by more than 158% annually just to break even. Respondent settled for a six-month suspension and a $5,000 fine.

The notable part of this first FINRA Reg BI settlement is simply that it is a re-labeled churning case that could have been brought under other FINRA rules, such as FINRA Rule 2111 (suitability), possibly FINRA Rule 2020 (manipulation), or even Exchange Act Section 10(b), Rule 10b-5 (fraud). As such, it plows no new ground. Instead, it is a telling sign that FINRA's prior authority over retail trading is now greatly diminished as the SEC wields its new tool — Reg BI — over such trading, while FINRA's suitability rule has been laid to rest, at least as it pertains to retail trading. See "SEC Files Groundbreaking Reg BI Complaint," *Expect Focus – Life Annuity and Retirement Solutions* (August 2022).

Still, it should be remembered that the SEC has, in the past, taken the initial lead in prosecuting major violations of new Exchange Act rules (e.g., Exchange Act Rule 15c3-5, the "market access rule," adopted in 2010) with FINRA filling the gaps at first, and then gradually replacing the SEC as the primary regulator for all but the largest cases. In a few years, expect FINRA to be handling the majority of Reg BI cases.

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