

Alert | Securities Litigation



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Reg BI Enforcement Intensifies: SEC Fines Western International Securities for Violating Care and Compliance Obligations

Go-To Guide:

- Western International Securities Inc. (Western) settled two separate cases with the Securities and Exchange Commission (SEC) regarding alleged violations of Regulation Best Interest (Reg BI).
- Between both settlements, the SEC and Financial Industry Regulatory Authority (FINRA) ordered Western to pay over \$1.7 million in civil penalty fines.
- Through the “Care Obligation” and the “Compliance Obligation,” Reg BI is intended to protect investors by requiring broker-dealers to operate in the best interest of their clients.
- Broker-dealers should be aware of the SEC and FINRA’s increase in enforcement actions on Reg BI compliance.

On July 30, 2024, the SEC **announced** it had reached a settlement agreement with Western, a dually registered investment adviser and broker-dealer providing investment advice and brokerage services to retail customers, for allowing a former representative to engage in a strategy of day-trading options that the SEC contended was not in retail customers’ best interests.

Background

Reg BI is a safeguard rule under the Securities Exchange Act of 1934 (Exchange Act) that establishes a fiduciary “best interest” standard of conduct for broker-dealers when they recommend or implement trading strategies for customers in any security transaction. Reg BI states that a broker-dealer must “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...ahead of the interest of the retail customer.”

Reg BI details both a “Care Obligation” that requires broker-dealers to have a reasonable basis to recommend an investment strategy or a securities transaction to be in the best interest of their clients and a “Compliance Obligation” that requires broker-dealers to establish written policies and procedures that align with Reg BI. In conjunction with Reg BI, the SEC also requires broker-dealers to provide retail investors with a “relationship summary” that, among other things, discloses brokerage fees, costs, and potential conflicts of interest (Form CRS).

Every year since Reg BI’s June 2020 effective date, the SEC’s Division of Examinations has listed Reg BI and Form CRS as a priority for broker-dealer examinations in its annual statement of examination priorities, including in its 2024 Examination Priorities. FINRA has matched the SEC’s focus in this area in that it has brought over 40 enforcement actions since 2023 and has settled over 30 cases since the inception of the regulation. As evidenced by the recent settlements detailed in this GT Alert, the agencies continue to emphasize that they will work together to bring enforcement actions on behalf of retail investors and hold broker-dealers accountable.

SEC v. Western International Securities, et al.

The SEC alleged that Western failed to enforce its procedures designed to comply with Reg BI, and in turn violated Exchange Act Rule 15l-1(a)(1). The SEC noted in its order that Western “failed to enforce its policies and procedures designed to achieve compliance” with Reg BI’s “Compliance Obligation.” Western, without admitting to or denying the allegations, agreed to a censure, a cease and desist, and a \$140,000 civil money penalty. Notably, and consistent with recent staff pronouncements about cooperation, the order highlighted Western’s cooperation, which included providing information that the SEC had not yet uncovered and providing tables summarizing information.

In a separate suit also involving Western that the SEC filed in the Central District of California in June 2022 (the California Action), the SEC announced on July 31, 2024, that it reached a settlement agreement with Western and five of its registered representatives, ending allegations that they violated Rule 15l-1(a)(1) of the Exchange Act, specifically, the “best interest” standard of Reg BI.

In the California Action, the SEC alleged that from July 2020 through April 2021, the Western defendants failed to comply with Reg BI’s “Care Obligation” by recommending and selling a total of \$13.3 million unrated, and high-risk securities known as “L Bonds” to retail customers with “moderate risk tolerances” and without having a reasonable basis to believe that the L Bonds were in the investors’ best interests. The SEC also alleged that the individual defendants did not understand the key risks associated with the L Bonds. The California Action was the first time the SEC brought suit claiming Reg BI violations.

The complaint further alleged that Western failed to comply with the “Compliance Obligation” of Reg BI by neglecting to maintain and enforce sufficient written policies and procedures.

In accordance with the proposed California Action settlement agreement, without admitting or denying the SEC’s allegations, Western consented to the entry of a final judgment that permanently enjoins them

from violating Reg BI and orders them to pay a \$160,000 civil penalty as well as disgorgement of the commissions and fees it retained, totaling over \$34,000. Also, without admitting or denying the allegations of the SEC's complaint, the five individual representatives agreed to pay \$12,500 in civil penalties as well as disgorgement of all the commissions they received. The settlement proposal requires court approval to be finalized.¹

These SEC actions align with other recent Reg BI enforcement actions.² Broker-dealers should take note of the both the SEC and FINRA's heightened focus on Reg BI compliance and ensure they are meeting their Care and Compliance obligations.

See additional GT insights on Regulation Best Interest.

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¹ In addition to the SEC settlement agreements, on July 29, 2024, FINRA **fined Western** \$475,000 and ordered Western to pay more than \$1 million in restitution for having failed to establish, maintain, and enforce a supervisory system reasonably designed to supervise actively traded accounts in violation of FINRA Rules 3110 and 2010. FINRA accused Western of permitting excessive and unsuitable trading in approximately 100 accounts, causing customers to pay total trading costs of more than \$2.5 million. Western consented to the sanctions without admitting or denying FINRA's allegations. FINRA charged Western with violations of its Rule 2111 which, while still in effect, no longer applies to recommendations to retail customers subject to Regulation BI as of June 30, 2020.

² See *In the Matter of TIAA-CREF Individual & Institutional Services, LLC*, File No.: 3-21856 (2024); See *In the Matter of Key Investment Services, LLC*, File No.: 3-21849 (2024)

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