

June 18, 2019

SEC Adopts Form CRS Relationship Summary Requirement



As part of its package of new rules, forms and interpretations under both the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934, the Securities and Exchange Commission has adopted a requirement that registered investment advisers and registered broker-dealers provide a brief relationship summary to retail investors on Form CRS.

This Client Alert focuses on the practical process of drafting, filing, updating and delivering Form CRS as well as legal implications for advisers and broker-dealers subject to this new requirement.

I. Purpose

The overarching purpose of the relationship summary is “to reduce retail investor confusion in the marketplace for brokerage and investment advisory services and to assist retail investors with the process of deciding whether to engage, or to continue to engage, a particular firm or financial professional and whether to establish, or to continue to maintain, an investment advisory or brokerage relationship.”¹

Following the proposal of Form CRS in April 2018, the SEC’s Office of the Investor Advocate engaged the RAND Corporation to conduct investor testing on the proposed relationship summary through the administration of surveys and qualitative interviews of individual participants.² Many commenters on the proposal expressed dissatisfaction with the scope and design of the study.

For instance, one commenter stated that “the RAND Testing was not sufficiently rigorous to appropriately assess the effectiveness of Form CRS, and we strongly believe that it does not provide a reasonable basis upon which to adopt Form CRS as proposed.”³ As a result, commenters urged the SEC to delay its finalization of the proposed form until it could be determined that the disclosure in Form CRS and its utility to dispel investor confusion work as intended.

Despite these concerns, the SEC adopted the final rule without delay for further testing. In its release, the SEC noted that while it “considered this input” from commenters and used it to inform certain policy choices, “feedback we have received from or on behalf of retail investors through the RAND 2018 report, surveys and studies submitted by commenters, and input received at roundtables and on Feedback Forms, demonstrate that the proposed relationship summary would be useful for retail investors and provide information, e.g., about services, fees and costs, and standard of care, that would help investors to make more informed choices when deciding among firms and account options.”⁴

In the adopting release, the SEC provides for a review of the effectiveness of Form CRS to help ensure that it “fulfills its intended purpose.”⁵ In particular, the SEC directs the staff to review a sample of relationship summaries and provide the SEC with results of this review. There are no further details regarding the scope or timing of the review, or what the SEC will do with the staff’s report once it is provided.

Time will tell whether Form CRS will ultimately be effective to assist retail investors in understanding the scope of their engagement with an investment adviser, broker-dealer or dual registrant.

II. Presentation and Format

In response to several commenters arguing that the proposed Form CRS was too long and incomprehensible, the SEC resolved to streamline its presentation and format of Form CRS in adopting the final rule.

Instead of the four-page relationship summary that was proposed, the summary will now be limited to two pages (or four pages for dual registrants). Unlike the proposed instructions, the final instructions do not prescribe paper size, font size and margin width, but say only that they must be “reasonable.”⁶ The instructions also indicate that registrants should include white space and implement other design features to make the relationship summary easy to read.

Some commenters to the proposed Form CRS argued that the use of prescribed language in the instructions and the “one size fits all” approach would not appropriately address the various accounts, services and models of investment advisory and brokerage firms and therefore could be misleading to retail investors. Commenters urged the SEC to allow firms to craft their own relationship summary so that it can be tailored to the different types retail investors they service. In its adopting release, the SEC explained that, while firms will still be required to respond to a list of required topics in a prescribed order, firms will now have the flexibility to generally use their own wording to respond to the items on Form CRS.⁷

Several commenters to the proposed Form CRS also called for “layered” disclosure in the relationship summaries, whereby additional information could be found through cross-references, embedded URLs and QR codes. Commenters argued that “layered” disclosure would shorten and simplify the

form, as well as help to alleviate the burden of having to disclose complex information that retail investors are unlikely to read. In its adopting release, the SEC states that the instructions now permit, and in some instances require, layered disclosures and otherwise encourage the use of charts, graphs, tables and other graphics to help retail investors easily digest the information.⁸

Additionally, in response to commenters, roundtable participants and the RAND study, which suggested that retail investors were confused with industry jargon, the final release states that in crafting their responses on Form CRS, firms will not be permitted to use legal jargon or highly technical business terms – such as “asset-based fee” and “load” – unless firms clearly explain them in plain English, even if the firm believes a reasonable retail investor would understand those terms.⁹

While the scope of the information required within the relationship summary has been modified in light of commenter concerns, firms are still obligated to provide accurate information and may not omit any material facts necessary to make the required disclosures, in light of the circumstances under which they were made, not misleading.¹⁰ According to the SEC, the phrase, “*in light of the circumstances under which they were made,*” was added to the final instructions in order to clarify that the disclosure is intended to be a summary, that firms must still adhere to the page limit, and that the instructions encourage firms to reference or link to additional information.¹¹ Form CRS is “not intended to create a private right of action.”¹²

As a practical matter, firms may find it difficult to adhere to these requirements in a paper-based relationship summary. In such a format, firms must ensure that all material facts and disclosures are provided, that all technical terms are fully explained, and charts, tables or other graphics intended to help investors understand the information all fit within the confines of the two or four-page summary limit. It is unclear whether it is practical, or even possible, to disclose such information in a paper-based format within these page constraints. While the SEC permits hyperlinks and QR codes to be embedded in the text of a paper-based summary, questions remain as to the likelihood that retail investors would separately access the links provided.

III. Standards of Conduct

The RAND 2018 Report and other surveys found that retail investors struggled to understand the standard of care for broker-dealers and investment advisers after reading the proposed Form CRS, and RAND reported that survey participants especially had difficulty reconciling the information provided in the “Obligations to You” section and the “Conflicts of Interest” section. In addition, commenters noted that retail investors did not understand the differences between a “best interest” and “fiduciary” standard, with at least one commenter noting that the confusion is likely attributable to a lack of clarity regarding the standards themselves. Yet as shown in the final release

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for Regulation Best Interest, broker-dealers and investment advisers will continue to be subject to different standards of conduct despite the SEC's efforts to harmonize the obligations.

In the final release, firms will remain subject to the requirement to describe their legal standard of conduct using prescribed wording, but the standard of conduct disclosure is provided in the conflicts of interest section.¹³ The modified standard of conduct disclosure now eliminates legal jargon, such as "fiduciary," and instead uses the term "best interest" across the board, to describe how broker-dealers, investment advisers, and dual registrants must act regarding their retail customers or clients when providing recommendations as a broker-dealer or when acting as an investment adviser.

This decision is notable, considering that the final form of Regulation Best Interest still does not place a "fiduciary standard" on broker-dealers, and thus one could argue that the standards of conduct are inherently different. The harmonizing of the standard of care under Form CRS, however, appears to imply that the broker-dealer standard is as high as a fiduciary standard, even though it is not defined as such. In this regard, the SEC noted that, "we believe that requiring firms – whether broker-dealers, investment advisers, or dual registrants – to use the term 'best interest' to describe their applicable standard of conduct will clarify for retail investors their firm's legal obligation in this respect, regardless of whether that obligation arises from Regulation Best Interest or an investment adviser's fiduciary duty under the Investment Advisers Act."¹⁴

The SEC states in the adopting release that the prescribed language describing the standard of conduct broker-dealers and investment advisers owe to their customers and clients is not intended to create a private right of action.¹⁵ The SEC did not address the possibility that such disclosures might support claims under existing private rights of action, such as that under rule 10b-5 under the Exchange Act.

IV. Contents of the Relationship Summary

The final instructions for the relationship summary require a question-and-answer format, with standardized questions serving as the headings in a prescribed order to promote consistency and comparability. The headings will be structured and machine-readable. Under the standardized headings, firms will generally use their own wording to address the required topics, although some specific disclosures are prescribed. Firms will also be required to link to additional information, which for investment advisers will be to their Form ADV Part 2A brochures or equivalent information and for broker-dealers will be to their Regulation Best Interest disclosures.

In particular, the required headings address: (i) identifying information about the firm and a link to the SEC's website; (ii) the types of client and customer relationships and services each firm offers; (iii) the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; (iv) whether the firm and its financial professionals currently have reportable legal or disciplinary history; and (v) how to obtain additional information about the firm.

Some of the "Key Questions to Ask" from the proposal have been integrated into the relationship summary sections as required "conversation starters." The SEC intends that retail investors can use these questions to engage in dialogue with their financial professionals about their individual circumstances.

V. Delivery, Filing, Updating and Recordkeeping Requirements

Under the final rule, investment advisers and broker-dealers will be obligated to deliver a relationship summary to retail investors at a certain time before or during the engagement, file copies of their relationship summaries with the SEC, update the disclosures when the information becomes materially inaccurate, and communicate any changes to retail investors who are existing clients or customers.

The relationship summary requirement applies to investment advisers and broker-dealers with retail investors. If a firm does not have any retail investors, it is not required to prepare or file a relationship summary. In particular, it appears that investment advisers to institutional separate accounts, private funds and registered funds will not be required to deliver Form CRS. In addition, the adopting release states that the SEC would not consider a broker-dealer that is serving solely as a principal underwriter to a mutual fund or variable annuity or variable life insurance contract issuer to be offering services to a retail investor for this purpose, when acting in such capacity.¹⁶

a. Retail Investor

The SEC's final rule defines a retail investor as a natural person, or the legal representative of a natural person, who seeks to receive or receives services primarily for personal, family or household purposes. The SEC interprets a "legal representative" of a natural person to cover only non-professional legal representatives (e.g., a non-professional trustee that represents the assets of a natural person and similar representatives such as executors, conservators, and persons holding a power of attorney for a natural person).¹⁷ The definition excludes natural persons seeking services for commercial or business purposes (though a relationship summary is required to be delivered to those persons who might be seeking services for a mix of personal and commercial or other non-personal purposes).¹⁸ The definition does not distinguish based on a net worth or other asset threshold.¹⁹ In addition, in response to commenter concerns regarding whether the definition includes plan participants, the SEC clarified that the definition will include a natural person seeking to select and retain a firm to provide brokerage or advisory services for his or her own retirement account, including but not limited to IRAs and individual accounts in workplace retirement plans, such as 401(k) plans and other tax-favored retirement plans.²⁰

In its adopting release, the SEC stated that while the final instructions adopt a definition of "retail investor" that is consistent with the definition of "retail customer," it differs to reflect differences between the relationship summary delivery requirements and the obligations of broker-dealers under Regulation Best Interest, including "that the relationship summary is required whether or not there is a recommendation and covers any prospective and existing clients and customers (i.e., a person who 'seeks to receive or receives services') of both investment advisers and broker-dealers."²¹

b. Delivery

For investment advisers, the SEC requires delivery of a relationship summary before or at the time the firm enters into an investment advisory contract and is intended to generally track the initial delivery requirement for Form ADV Part 2A. However, in a change from the proposal, broker-dealers must deliver the relationship summary to each new or prospective customer who is a retail investor before or at the earliest of one of three triggers: (i) a recommendation of an account type, a securities transaction, or an investment strategy involving securities; (ii) placing an order for the retail investor;

or (iii) the opening of a brokerage account for the retail investor. Dual registrants, and affiliated broker-dealers and investment advisers that jointly offer their services, must deliver at the earlier of the initial delivery triggers for an investment adviser or a broker-dealer.

In response to commenters' concerns, the SEC also adopted rules for delivery when changes are made to an existing account that would "materially change the nature and scope" of the firm's relationship with the retail investor. For example, firms will be required to deliver the relationship summary to existing retail investors: (i) before or at the time firms open a new account that is different from the retail investor's existing account; (ii) when they recommend that the retail investor roll over assets from a retirement account; or (iii) when they recommend or provide a new service or investment outside of a formal account (e.g., variable annuities or a first-time purchase of a direct-sold mutual fund through a "check and application" process).

To facilitate retail investors receiving the relationship summary as early as possible, a firm may deliver the initial relationship summary to a new or prospective client or customer in a manner that is consistent with how the retail investor requested information about the firm or financial professional (e.g., by email if information requested by email).²² The SEC is not requiring that firms make the initial relationship summary available in paper format and believes that retail investors that prefer paper communications will have the opportunity to establish relationships with firms that accommodate paper delivery.²³ With respect to existing clients or customers, firms must comply with the SEC's electronic delivery guidance, which provides that a person who has a right to receive a document under the federal securities laws and chooses to receive it electronically, should be provided with the information in paper form whenever specifically requesting paper.²⁴

c. Filing

Relationship summaries will be filed by broker-dealers on Form CRS through Web CRD and by investment advisers as Form ADV Part 3 (Form CRS) through IARD, using a text-searchable format. Dual registrants will file using both IARD and Web CRD. The use of Web CRD instead of EDGAR, as proposed, is to allow broker-dealers to use a platform which, according to commenters, is more accessible and familiar to them. The summaries will be accessible via the SEC's public website, Investor.gov, in addition to each firm's website.²⁵

d. Updating

Broker-dealers and investment advisers must update the relationship summary and file it within 30 days whenever any information in it becomes materially inaccurate, and any changes must be communicated to existing clients or customers within 60 days (instead of 30 days as proposed). In a change from the proposal, the SEC also added a requirement that firms delivering updated relationship summaries to existing clients or customers must highlight the most recent changes by, for example, marking the revised text or including a summary of material changes.²⁶ This additional disclosure must be filed as an exhibit to the unmarked amended relationship summary (but would not be counted toward the two-page or four-page limit, as applicable).

e. Recordkeeping

The SEC is adopting amendments to the recordkeeping and record retention requirements under Advisers Act rule 204-2 and Exchange Act rules 17a-3 and 17a-4. Pursuant to paragraph (a)(14)(i) of

Advisers Act rule 204-2 as amended, investment advisers will be required to make and preserve a record of the dates that each relationship summary was given to any client or prospective client who subsequently becomes a client. New paragraph (a)(24) of Exchange Act rule 17a-3, as adopted, will require broker-dealers to create a record of the date on which each relationship summary was provided to each retail investor, including any relationship summary provided before such retail investor opens an account. In addition, paragraph (a)(14)(i) of Advisers Act rule 204-2, as amended, will require investment advisers to retain copies of each relationship summary and each amendment or revision thereto while paragraph (e)(10) of Exchange Act rule 17a-4, as amended, will require broker-dealers to maintain and preserve a copy of each version of the relationship summary as well as the records required to be made pursuant to new paragraph (a)(24) of Exchange Act rule 17a-3. The amended rules also set forth the manner in which and the period of time for which these records must be retained.

The recordkeeping requirements were adopted as proposed, despite concerns from commenters that the requirements as written would be burdensome, especially with regard to maintaining records of prospective clients and customers who do not become clients or customers. The SEC indicated that the collection of information will be used in its examination and oversight program.²⁷

VI. Compliance Date

In the final rule, the SEC extended the time to comply with the relationship summary requirements. In the adopting release, the SEC noted that firms that are registered, or investment advisers who have an application for registration pending, with the Commission prior to June 30, 2020, will have a period of time beginning on May 1, 2020 until June 30, 2020 to file their initial relationship summaries with the SEC. On and after June 30, 2020, newly registered broker-dealers will be required to file their relationship summary with the SEC by the date on which their registration with the SEC becomes effective, and the SEC will not accept any initial application for registration as an investment adviser that does not include a relationship summary that satisfies the requirements of Form ADV, Part 3: Form CRS.²⁸ It is not clear what the review process will be at the SEC for relationship summaries and whether that process could slow down effectiveness of newly registering investment advisers, or whether existing broker-dealers and investment advisers should anticipate comments on their relationship summaries.

Firms will be required to deliver their relationship summary to new and prospective clients and customers who are retail investors as of the date by which they are first required to electronically file their relationship summary with the SEC. In addition, firms will be required, as part of the transition, to deliver their relationship summaries to all existing clients and customers who are retail investors on an initial one-time basis within 30 days after the date the firm is first required to file its relationship summary with the SEC.

¹ *Form CRS Relationship Summary; Amendments to Form ADV*, Release Nos. 34-86032, IA-5247, at 5 (June 5, 2019) (footnotes omitted), <https://www.sec.gov/rules/final/2019/34-86032.pdf>; see also Exhibit B: Instructions to Form CRS, <https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf>.

² *Form CRS Relationship Summary*, *supra* Note 1, at 9.

³ Investment Adviser Association, *Investor Testing of Form CRS Relationship Summary*, at 2 (Dec. 4, 2018), <https://www.sec.gov/comments/s7-08-18/s70818-4728888-176762.pdf>. See also Consumer

Federation of America, File No. S7-08-18, Form CRS Relationship Summary, at 1 (Dec. 7, 2018), <https://www.sec.gov/comments/s7-08-18/s70818-4734907-176790.pdf> (the “inescapable conclusion” from the study is that the disclosures in the proposed Form CRS do not, as currently conceived, “actually support informed investor decision-making” and that many investors still fail to understand “key information that would help them determine whether a brokerage or advisory account would best suit their needs.”).

⁴ *Form CRS Relationship Summary*, *supra* Note 1, at 11 - 12.

⁵ *Id.* at 28 - 29.

⁶ The adopting release indicates that 8½” x 11” paper size, at least an 11 point font size, and a minimum of 0.75” margins on all sides could be considered reasonable, but other parameters could also be reasonable. *Id.* at 48.

⁷ *Id.* at 21, 37.

⁸ *Id.* at 21 - 22.

⁹ *Id.* at 33.

¹⁰ Instructions to Form CRS, *supra* Note 1, General Instruction 2.B.

¹¹ *Form CRS Relationship Summary*, *supra* Note 1, at 42 (emphasis in original).

¹² *Id.* at 43.

¹³ *Id.* at 143 - 44.

¹⁴ *Id.* at 153 - 54.

¹⁵ *Id.* at 145.

¹⁶ *Id.* at 224 - 25.

¹⁷ *Id.* at 195. In other words, delivery of the relationship summary to regulated financial services professionals acting as representatives of a natural person is not required.

¹⁸ *Id.* at 193.

¹⁹ *Id.* at 193 - 94.

²⁰ *Id.* at 197. In addition, the SEC noted that participants in 401(k) plans and other workplace retirement plans will not be retail investors for purposes of the Form CRS delivery obligation when making certain ordinary plan elections that do not involve selecting or retaining a firm to provide brokerage or advisory services. *Id.* at 198.

²¹ *Id.* at 191.

²² *Id.* at 207 - 08.

²³ *Id.* at 213 - 14.

²⁴ *Id.* at 208, 211 - 212; see Use of Electronic Media by Broker- Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release Nos. 33-7288, 34-37182, IC-21945, IA-1562 (May 9, 1996), 61 Fed. Reg. 24644, 24646 (May 15, 1996), <https://www.govinfo.gov/content/pkg/FR-1996-05-15/pdf/96-12176.pdf>.

²⁵ *Form CRS Relationship Summary*, *supra* Note 1, at 201.

²⁶ *Id.* at 189.

²⁷ *Id.* at 479.

²⁸ *Id.* at 239.