



## Getting the full picture

The emerging best interest and fiduciary duty patchwork

July 10, 2019

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### Form CRS: Implementation Considerations

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#### What happened?

On June 5, in a three-to-one vote, the US Securities and Exchange Commission (SEC) adopted a comprehensive package of rulemakings and interpretations governing the standard of conduct applicable to broker-dealers providing retail investment advice and the fiduciary duty applicable to SEC-registered investment advisers. The package includes the following specific components:

- a new rule establishing a standard of conduct (captioned as “Regulation Best Interest”) for broker-dealers and natural persons who are associated persons of a broker-dealer when making recommendations to retail customers of any securities transaction or investment strategy involving securities or regarding the opening of an account;<sup>1</sup>
- new rules requiring registered broker-dealers and investment advisers to provide retail investors a brief relationship summary titled “Form CRS Relationship Summary”;<sup>2</sup>
- an interpretation of the fiduciary duty applicable to SEC-registered investment advisers;<sup>3</sup> and
- an interpretation of the “solely incidental” prong of Section 202(a)(11)(C) of the Investment Advisers Act of 1940 (which provides an exclusion from the definition of investment adviser for broker-dealers who provide investment advice on a solely incidental basis to their brokerage activities and do not receive any special compensation for it).<sup>4</sup>

Commissioners Clayton, Peirce and Roisman voted to adopt the package of rulemakings and interpretations, while Commissioner Jackson did not. A compliance date of June 30, 2020, is set for Regulation Best Interest and Form CRS. The SEC’s two interpretations under the Investment Advisers Act of 1940 will become effective upon publication in the *Federal Register*, which has yet to occur as of the date of this publication.

This alert focuses on the Form CRS Relationship Summary, and offers a series of “implementation considerations” for in-house legal and compliance professionals to consider as firms tackle operational challenges presented by the new rules.

#### The New Relationship Summary

##### Overview of the Form CRS Rulemaking History

On April 18, 2018, the SEC issued a release (the “Form CRS Proposing Release”)<sup>5</sup> soliciting comment on a proposed Form CRS Relationship Summary (“proposed Form CRS”) which prescribed the contents of a

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1 See “Regulation Best Interest: The Broker-Dealer Standard of Conduct,” SEC Release No. 34-86031 (June 5, 2019), available at: <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

2 See “Form CRS Relationship Summary; Amendments to Form ADV,” SEC Release Nos. 34-86032; IA-5247 (June 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86032.pdf> (the “Form CRS Adopting Release”).

3 See “Commission Interpretation Regarding Standard of Conduct for Investment Advisers,” SEC Release No. IA-5248 (June 5, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>.

4 See “Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser,” SEC Release. No. IA-5249 (June 5, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5249.pdf> (the “Solely Incidental Interpretation”).

5 *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles*, 83 Fed. Reg. 21416 (May 9, 2018). All citations in this legal alert to the Form CRS Proposing Release are to the version published in the Federal Register.

relationship summary to be filed with the SEC and delivered to retail investors.<sup>6</sup> In addition, the Form CRS Proposing Release proposed the adoption of a new rule restricting broker-dealer use of certain names or titles (the “Adviser Title Proposal”) as well as other new rules requiring broker-dealers and investment advisers and certain of their associated or supervised persons to disclose their registration status in retail investor communications (the “Registration Status Proposal”).

On June 5, the SEC adopted the Form CRS Relationship Summary (“Form CRS”) as well as certain related rulemakings (the “Form CRS Rules”) requiring broker-dealers and investment advisers to file Form CRS relationship summaries with the SEC (through the CRD and IARD systems) and deliver Form CRS relationship summaries to retail investors. However, the SEC did not move forward with adoption of the Adviser Title Proposal<sup>7</sup> or the Registration Status Proposal.<sup>8</sup>

### What do the Form CRS Rules require?

**Presentation and Format.** The Form CRS Rules require a firm’s Form CRS relationship summary to be limited to a maximum of two pages (or equivalent length if provided in electronic format) for stand-alone broker-dealers and investment advisers; and for firms that are registered as both broker-dealers and investment advisers (“dual registrants”), the SEC encourages preparation of a single relationship summary discussing both the brokerage and investment advisory services offered.<sup>9</sup> However, dual registrants may prepare two separate relationship summaries that reference each other and provide a means of facilitating access to the other, and must deliver to each retail investor both relationship summaries with “equal prominence and at the same time, without regard to whether the particular retail investor qualifies for those retail services or accounts.”<sup>10</sup> Additionally, broker-dealers or investment advisers with affiliates who also provide brokerage or investment advisory services to retail investors have the option to prepare a single relationship summary discussing the services provided by the registrant and its affiliate but may prepare separate relationship summaries for each entity’s services.<sup>11</sup> Regardless of the combined or separate approach, each summary must be designed in a manner that “presents the brokerage and investment advisory information with equal prominence and clearly distinguishes and facilitates comparison of the two types of services.”<sup>12</sup> In the case of a dual registrant who provides both brokerage and investment advisory services on behalf of itself and an affiliate, each retail investor must receive both the dual registrant’s and the affiliate’s relationship summaries with “equal prominence and at the same time” without regard as to whether the retail investor can take advantage of those services or accounts.<sup>13</sup> A Form CRS relationship summary may be provided to retail investors in a variety of formats, including video or audio formats. Firms are encouraged to use charts, graphs, tables, and other graphics or text features in order to respond to the required disclosures.<sup>14</sup>

**Implementation considerations:** The SEC noted that firms should consider the applicability of certain antifraud provisions of the federal securities laws when preparing the Form CRS relationship summary, including Section 206 of the Advisers Act and Section 10(b) of the 1934 Act and Rule 10b-5 thereunder. In doing so, in-house legal and compliance professionals would be well suited to review the presentation and content of the Form CRS relationship summary, with an eye to any potentially misleading statements or omissions of material facts.

**Content.** A firm’s Form CRS relationship summary must have succinct disclosures under five separate items, that is, an introduction and an additional four items:

- **Introduction:** Firms must indicate that brokerage and investment advisory services and fees differ, and that it is important for a retail investor to understand the differences between these two types of services and fees;
- **Item 2 (Relationship and Services):** Firms must describe the relationships and services offered to retail investors, including a discussion of whether the firm provides monitoring services, its potential investment authority, any limitations on investment offerings, and account minimums and other requirements;

6 *Id.* As part of the Form CRS Proposing Release, the SEC provided sample relationship summaries for broker-dealers, investment advisers and firms that are registered as both broker-dealers and investment advisers. *See id.* at Appendices C, D, and E.

7 The Adviser Title Proposal in the proposed Form CRS has been addressed in the context of Regulation Best Interest’s Disclosure Obligation. The SEC has noted in the Regulation Best Interest Adopting Release that it no longer believes a separate rule is necessary, because it “presume[s] that the use of the term ‘adviser’ and ‘advisor’ in a name or title by (1) a broker-dealer that is not also registered as an investment adviser or (2) an associated person that is not also a supervised person of an investment adviser, to be a violation of the capacity disclosure requirement under the Disclosure Obligation [in Regulation Best Interest].” *See* Regulation Best Interest Adopting Release at the text accompanying n. 324.

8 The SEC clarified that Form CRS requires broker-dealers and investment advisers to “state clearly” key facts about the relationship they could have with the client, “including their registration status.” *Id.* at n. 354.

9 *See Form CRS General Instructions, app. B*, 1934 Act Release No. 34-86032 (June 5, 2019) at 5 (“Instructions to Form CRS”).

10 *Id.* at 5.

11 *Id.* at 5-6.

12 *Id.*

13 *Id.*

14 *Id.* at 3-4.

- **Item 3 (Fees, Costs, Conflicts, and Standard of Conduct):** Under the heading “What fees will I pay?” a firm must provide detailed descriptions about the fees and costs that retail investors will pay,<sup>15</sup> any conflicts of interest, and the applicable standard of conduct, including:
  - » a description of principal fees and costs;
  - » a description of other fees and costs;
  - » additional information related to costs;
  - » conversation starters (as discussed below) related to costs.<sup>16</sup>

Both broker-dealers and investment advisers must describe their legal obligations, how they “make money” and any conflicts that they have.

- **Item 4 (Disciplinary History):** Under the heading “Do you or your financial professionals have legal or disciplinary history?” a firm must provide disclosures of any disciplinary information. If neither the firm nor its financial professionals have information to disclose, the firm must respond to this heading with “No.”<sup>17</sup>; and
- **Item 5 (Where to Find Additional Information):** A firm must state prominently where a retail investor can find additional information about the brokerage or investment advisory services it offers. Each firm must also provide a telephone number and state where a retail investor can request an up-to-date copy of the relationship summary.<sup>18</sup>

**Implementation considerations:** The SEC acknowledged that certain disclosures in the Form CRS relationship summary may be a helpful starting point for the Disclosure Obligation in Regulation Best Interest. The SEC noted that certain other disclosures in the Form CRS relationship summary, such as conflicts, fees and costs, will not be sufficient to satisfy the Disclosure Obligation in Regulation Best Interest and that the Regulation Best Interest disclosure may need to disclose additional conflicts and in more specific detail than in the Form CRS relationship summary.<sup>19</sup> Firms will need to ensure consistency with and carefully analyze the relationship between the disclosures in Form CRS and satisfying the requirements of the Disclosure Obligation in Regulation Best Interest.

**Conversation Starters.** Items 2 through 5 must also include “conversation starters,” which are questions that retail investors are encouraged to ask their financial professional with the intention of prompting a discussion.<sup>20</sup> However, if a conversation starter is not applicable to a firm’s business, Form CRS permits the firm to omit or modify the conversation starter in its Form CRS relationship summary.<sup>21</sup>

**Implementation considerations:** Although Form CRS does not require written responses to these “conversation starters,” we believe that firms will want to actively train their representatives and prepare a script to address each of the conversation starters. For automated investment advisers and broker-dealers that provide services only online, those firms must include a section on their website with written answers to each conversation starter. For these automated advisory or brokerage firms, the firm must provide in the Form CRS relationship summary a hyperlink or other means of facilitating access to the section of their website with these written answers. In addition, if the firm provides automated investment advisory or brokerage services but also makes a financial professional available to discuss the firm’s services with the retail investor, then the firm must make the financial professional available to discuss the “conversation starters” with the retail investor.

**Filing Requirements.** A broker-dealer or investment adviser that is already registered with the SEC may electronically file its initial Form CRS relationship summary as early as May 1, 2020 but must file no later than June 30, 2020.<sup>22</sup> A broker-dealer’s or investment adviser’s Form CRS relationship summary must be amended and filed within 30 days after any information in its relationship summary becomes materially inaccurate (effectively requiring the relationship summary to be updated within 30 days).<sup>23</sup> When filing an amended Form CRS relationship summary, an investment adviser or broker-dealer must

15 Within Fees and Costs, separate sections discussing principal fees and costs, fees and costs related to the firm’s services and investments, and other ways the firm and its affiliates make money, are required. See Form CRS Adopting Release at the text accompanying n. 373.

16 See Instructions to Form CRS, at p.14.

17 *Id.* at 17.

18 *Id.*

19 See Regulation Best Interest Adopting Release at nn. 297-8 and accompanying text.

20 See Instructions to Form CRS, at 12-8; See Form CRS Adopting Release at the text accompanying nn. 180-81.

21 See Instructions to Form CRS, at 3.

22 1934 Act Rule 17a-14(f); Advisers Act Rule 204-1(e). Broker-dealers must file their relationship summaries through the CRD. 1934 Act Rule 17a-14(b)(2). Investment advisers must file their relationship summaries through the IARD. Advisers Act Rule 204-1(a)(1). In addition, an investment adviser’s initial or amended relationship summary must be filed as an other-than-annual amendment if not filed as part of its annual updating amendment. Instructions to Form CRS, at 7.

23 Instructions to Form CRS, at 8; Form CRS Adopting Release at the text accompanying n. 769.

include an exhibit highlighting the most recent changes to its relationship summary (e.g., by marking the revised text or including a summary of the material changes).<sup>24</sup>

**Implementation considerations:** Firms should consider incorporating the updating requirements into their already existing regulatory reporting updating programs (e.g., Form BD, U-4, U-5, etc. and updates to Form ADV (if applicable)).

**Delivery Requirements.** The Form CRS Rules require delivery of Form CRS relationship summaries to retail investors. A broker-dealer must deliver its Form CRS relationship summary to a retail investor before or at the earliest of (i) a recommendation of an account type, securities transaction or investment strategy involving securities; (ii) placing an order for the retail investor; or (iii) the opening of a brokerage account.<sup>25</sup> Additionally, a broker-dealer must deliver its Form CRS relationship summary to a retail investor who is an existing customer before or at the time the broker-dealer (i) opens a new account that is different from the retail investor's existing account(s), (ii) recommends that the retail investor roll over assets from a retirement account into a new or existing account or investment, or (iii) recommends or provides a new brokerage service or investment that does not necessarily involve the opening of a new account and would not be held in an existing account.<sup>26</sup>

An investment adviser must deliver its Form CRS relationship summary to each retail investor before or at the time the investment adviser enters into an investment advisory contract with the retail investor.<sup>27</sup> Additionally, an investment adviser must deliver its Form CRS relationship summary to each retail investor who is an existing client before or at the time the investment adviser (i) opens a new account that is different from the retail investor's existing account(s), (ii) recommends that the retail investor roll over assets from a retirement account into a new or existing account or investment, or (iii) recommends or provides a new investment advisory service or investment that does not necessarily involve the opening of a new account and would not be held in an existing account.<sup>28</sup>

Dual registrants are required to deliver a Form CRS relationship summary to each retail investor at the earlier of the delivery trigger for either broker-dealers or investment advisers.<sup>29</sup>

**Implementation considerations:** As discussed above, the initial Form CRS relationship summary may be electronically filed with the SEC as early as May 1, 2020 but must be filed no later than June 30, 2020. In addition to this filing requirement, the initial Form CRS relationship summary must be delivered to all existing retail investor clients on an initial, one-time basis within 30 days after the date the firm is first required to file its Form CRS relationship summary with the SEC. We are seeking clarification from the SEC as to whether this requirement means 30 days after the June 30, 2020 compliance date or 30 days after the firm files the initial Form CRS relationship summary with the SEC, in the event the firm files before June 30, 2020.

**Updating Requirements.** The Form CRS Rules require a firm to communicate any material changes made to its Form CRS relationship summary to each retail investor who is an existing customer or client within 60 days of the change and deliver its updated relationship summary to each retail investor who is an existing customer or client within 30 days upon request.<sup>30</sup>

**Recordkeeping Requirements.** The Form CRS Rules also impose recordkeeping requirements on broker-dealers and investment advisers. In the case of broker-dealers, these records must include the date that a Form CRS relationship summary is provided to each retail investor.<sup>31</sup> Notably, a broker-dealer must retain a record of having provided a relationship summary to a retail investor before or at the earlier of any recommendation of an account type, securities transaction or investment strategy involving securities, even if the retail investor never opens an account with the broker-dealer.<sup>32</sup> Similarly, investment advisers must keep a copy of each Form CRS relationship summary, including a copy of each amendment or revision to a relationship summary and a record of the dates that a relationship summary (or amended or revised relationship summary) is given to any client or to a prospective client who subsequently becomes a client.<sup>33</sup>

<sup>24</sup> Instructions to Form CRS, at 8.

<sup>25</sup> Exchange Act Rule 17a-14(c)(1).

<sup>26</sup> Exchange Act Rule 17a-14(c)(2).

<sup>27</sup> Advisers Act Rule 204-5(b)(1).

<sup>28</sup> Advisers Act Rule 204-5(b)(2).

<sup>29</sup> Instructions to Form CRS, at 7.

<sup>30</sup> Exchange Act Rule 17a-14(c)(4); Advisers Act Rule 204-5(b)(4).

<sup>31</sup> Exchange Act Rule 17a-3. Broker-dealer records must be kept for six years. Exchange Act Rule 17a-4.

<sup>32</sup> Exchange Act Rule 17a-4(e)(10); Exchange Act Rule 17a-3(a)(24).

<sup>33</sup> Advisers Act Rule 204-2(a)(14)(i). Investment advisers must keep records for a period of not less than five years after the end of the fiscal year during which the last entry was made on the record. Advisers Act Rule 204-2(e)(1).

**Implementation considerations:** In order to comply with this recordkeeping requirement, broker-dealers and investment advisers will need to document the delivery of the Form CRS relationship summary, even to prospective clients. As a practical matter, firms may prefer to bundle the Form CRS relationship summary with the delivery of other account onboarding documentation, such as the account agreement or investor questionnaires. Bundling the delivery of these documents may make it easier to document the delivery of the Form CRS relationship summary for the purposes of satisfying the recordkeeping requirements in the Form CRS Rule. However, the relationship summary must be the first document in the package of documents if firms present the customer with a package of bundled documents.

## What's Next?

Form CRS will become effective 60 days after it is published in the Federal Register and will include a transition period until June 30, 2020 to give what the SEC believes to be sufficient time to come into compliance. The SEC recognizes that the new rules will require changes to operations, including mandatory disclosures, and compliance systems. In response, the SEC is establishing an inter-Divisional Standards of Conduct Implementation Committee and is encouraging firms to "actively engage" with this committee as questions arise.

**Implementation considerations:** Firms will want to move quickly and begin implementation so that questions can come to the surface and be communicated and addressed by the SEC well in advance of the termination of the transition period.

## Contacts

For more commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland's [www.fiduciaryregulatory.com](http://www.fiduciaryregulatory.com).

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Eversheds Sutherland attorney with whom you regularly work.

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