

CLIENT ALERT

Form CRS Relationship Summary and Amendments to Form ADV

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Overview

On June 5, 2019, in connection with the adoption of Regulation Best Interest (“Reg. BI”) and the publication of interpretive guidance on the Investment Advisers Act of 1940, as amended (the “Advisers Act”),¹ the Securities and Exchange Commission established a new disclosure obligation for broker-dealers and investment advisers that provide services to natural persons, referred to as “retail investors.”² The new rules and forms (as well as amendments to existing rules and forms) were adopted under the Advisers Act³ and the Securities Exchange Act of 1934, as amended (the “Exchange Act”),⁴ 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.”⁵ The new rules require broker-dealers and investment advisers to send to retail investors and file with the

¹ See Regulation Best Interest, Exchange Act Release No. 34-86031 (June 5, 2019) (“Reg. BI Adopting Release”), Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Investment Advisers Act Release No. 5248 (Jun. 5, 2019) and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser; Investment Advisers Act Release No. 5249 (Jun. 5, 2019). For more information, please click [here](#) to read the Willkie Farr & Gallagher LLP Client Alerts.

² Form CRS Relationship Summary; Amendments to Form ADV, Exchange Act Release No. 86032 (Jun. 5, 2018) (the “Form CRS Adopting Release”).

³ See Advisers Act Rule 204-5.

⁴ See Exchange Act Rule 17a-14.

⁵ Form CRS Adopting Release at 5.

Form CRS Relationship Summary and Amendments to Form ADV

SEC a brief relationship summary, referred to as “Form CRS.” Form CRS is required to include disclosure regarding: (i) the types of customer relationships and services the firm offers; (ii) the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; (iii) disciplinary history of the firm and of its financial professionals; and (iv) how to obtain additional information about the firm. The disclosure must be “concise and direct”⁶ and comply with established requirements to allow retail investors to compare the products and services offered by different firms.⁷ Form CRS supplements existing disclosure requirements but does not replace the obligation for advisers to file, update and deliver Form ADV and for broker-dealers to file and update Form BD. Limited-purpose broker-dealers that act as principal underwriters to mutual funds and variable annuity or variable life insurance contracts and broker-dealers providing clearing services are not required to file and deliver Form CRS.

Persons to Whom New Form CRS Must Be Delivered

Broker-dealers must deliver Form CRS to each retail investor prior to or at the earliest of making a recommendation of an account type, securities transaction or investment strategy to, or opening a brokerage account or placing an order for, the retail investor. Investment advisers must deliver Form CRS to each retail investor before or at the time they enter into an investment advisory contract with such person.

The term retail investor refers to a natural person or legal representative of such person who “seeks to receive or receives services primarily for personal, family or household purposes.”⁸ The definition includes all natural person investors regardless of wealth or sophistication⁹ and is consistent with but not identical to the definition of “retail customer” in Reg. BI.¹⁰ The term “personal, family or household purposes” includes services related to retirement accounts, including not

⁶ *Id.* at 32. See also General Instruction 2.A. to Form CRS (providing that firms should: (i) use short sentences and paragraphs; (ii) use definite, concrete, everyday words; (iii) use the active voice; (iv) avoid legal jargon or highly technical business terms unless the terms are clearly explained; and (v) avoid multiple negatives; and noting that responses to each item should be written as if the firm were speaking to the retail investor, using “you,” “us,” “our firm,” etc.). Delivery of the relationship summary will not necessarily satisfy the additional requirements that broker-dealers and investment advisers are subject to under the federal securities laws and regulations or other laws or regulations. See General Instruction 2.D. to Form CRS; Proposed General Instruction 3 to Form CRS.

⁷ *Id.* at 19.

⁸ See §240.17a-14(e)(2) and §275.204-5(d)(2).

⁹ The scope of this definition is broader than the approach taken by the Financial Industry Regulatory Authority (“FINRA”), which treats many high net worth individuals as institutional accounts and exempts them from the scope of suitability obligations if specified conditions are met. See, e.g., FINRA Rule 2111(b) exempting “institutional accounts,” as defined in FINRA Rule 4512(c). As noted by the SEC, the definition of “retail investor” in the new rules is substantially the same as that in section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

¹⁰ The primary difference between the definition of “retail customer” in Reg. BI and that of retail investor for purposes of Form CRS is that the definition of retail investor is not tied to provision of a recommendation by the financial professional. See CRS Adopting Release at 148. For example, broker-dealers must provide Form CRS to retail customers with whom they have a “check and application” arrangement, under which the broker-dealer simply directs the customer to submit an application and a check for payment to the issuer of securities. *Id.* at 238.

Form CRS Relationship Summary and Amendments to Form ADV

only IRAs, but also workplace plans, such as 401(k) plans and other tax-favored savings arrangements such as Archer Medical Savings Accounts, Health Savings Accounts and 529 plans. Participants in 401(k) plans and other retirement plans are not deemed to be retail investors for purposes of Form CRS when making plan elections that do not involve selecting or retaining a firm to provide brokerage or advisory services.¹¹ The term “legal representative” means “non-professional legal representative,” excluding from the delivery requirement banks and other professional representatives.¹² Broker-dealers and investment advisers that serve as trustees or representatives to retail investors will be required to deliver a relationship summary to the retail-investor beneficiaries of the trusts and the vehicles they represent.

Format and Content of Form CRS

Form CRS is subject to specified requirements regarding format, length and content. The document may be no more than two pages long for firms that are registered exclusively as broker-dealers or as investment advisers and four pages long for firms that are dually registered. Dual registrants and affiliated broker-dealers and investment advisers may submit a combined form or two separate forms.¹³ Form CRS is designed to allow retail investors to compare services provided by investment advisers, broker-dealers and dual registrants to assist retail investors in deciding among the different types of firms, accounts and services available to them.¹⁴

Firms may provide their own descriptions and disclosures in response to specified questions in Form CRS and are encouraged to use graphics, on-line tools and hyperlinks to make the content user-friendly. The summary must use plain English and avoid using highly technical terms unless they are clearly explained. As an example, the SEC cited comment letters which suggested that terms such as “asset-based fee” and “load” should be viewed as unacceptable “jargon.”¹⁵ The disclosure must take into consideration the retail investors’ level of financial experience. Although the SEC does not prohibit firms from preparing different versions of Form CRS for different groups of retail investors, the Form CRS Adopting Release assumes that firms will use a single Form CRS for a range of retail investors. As a result, the instruction regarding customizing the disclosure based on client sophistication suggests that firms will need to ensure that

¹¹ For example, assistance to a 401(k) plan beneficiary by a firm through a call center interaction would generally not give rise to a duty to provide a Form CRS to that beneficiary. *Id.* at 198.

¹² *Id.* at 195.

¹³ Affiliated firms that provide brokerage and investment advisory services through financial professionals that are dually registered with both firms must deliver to each retail investor both firms’ relationship summaries with equal prominence and cross-reference and link to the other firm’s relationship summary. *Id.* at 76.

¹⁴ *Id.* at 19.

¹⁵ *Id.* at 33.

Form CRS Relationship Summary and Amendments to Form ADV

Form CRS is comprehensible to its least sophisticated retail investors unless a firm elects to file and use more than one form.

Although Form CRS should not be designed as marketing material, it may include a description of other financial services offered by the firm, such as insurance, banking, retirement services or investment advice pursuant to state registration, so long as the discussion of the other services does not “obscure” the description of the core brokerage and advisory services.¹⁶ Form CRS must include links to the SEC’s investor education website (investor.gov), which provides information and search tools for retail investors, including the ability to find information about registered investment advisers and broker-dealers.

The disclosure in Form CRS must be organized under standardized headings, be presented in a prescribed order, and include follow-up questions for retail investors to ask their financial representative or adviser, referred to as “conversation starters.”¹⁷ Robo advisers and other broker-dealers that offer automated or online services without providing a financial professional with whom a retail investor can discuss the conversation starters must include a section on their websites that includes answers to each of the conversation starters and a hyperlink from the Form CRS to the website. If firms provide a designated financial professional as a contact for particular retail investor account types, the firm must make the financial professional available to discuss the conversation starters with those retail investors covered by the financial professional.

Form CRS requires firms to describe their product and service offerings for retail investors, addressing each of the following: (i) monitoring services provided, including, but not limited to, account monitoring; (ii) whether an investment adviser accepts discretionary authority and any limitations on that authority;¹⁸ (iii) limited investment offerings; and (iv) account minimums and investor requirements.¹⁹ In addition, the following information must be included in Form CRS:

- a description of the ways in which the firm makes money;

¹⁶ *Id.* at 44 and 76-78.

¹⁷ *Id.* at 55. Examples of conversation starter questions include: “If I give you \$10,000 to invest, how much will go to fees and costs, and how much will be invested for me?” “How will you choose investments to recommend to me?”

¹⁸ Both broker-dealers and investment advisers offering non-discretionary advisory services must explain that the retail investor is responsible for making the ultimate decision regarding a recommended purchase or sale of a security. *Id.* at 103.

¹⁹ *Id.* at 94.

Form CRS Relationship Summary and Amendments to Form ADV

- the primary fees and costs that a retail investor would incur for the services provided,²⁰ including how frequently fees are assessed and ranges of fees, but not specific amounts, information about bundled fee structures, such as those used in wrap fee programs, and a discussion of the conflicts of interest the fee structure can create;
- whether the firm offers brokerage or investment advisory services (or both) and the particular types of services that it offers to retail investors;
- the standard of conduct applicable to the services provided;
- firm conflicts of interest, including those related to compensation received from third parties for recommending particular investments, and revenue sharing arrangements;
- financial professional compensation and related conflicts of interest;
- whether the firm and its financial representatives have been subject to disciplinary events and, if so, where investors can find information about the disciplinary events; and
- how to obtain additional information about the firm.²¹

Filing Requirements, Delivery, Updates and Public Availability of Form CRS

Broker-dealers must file Form CRS electronically through the Web CRD system, and investment advisers must file Form CRS through the IARD system. Each firm's Form CRS will be available on the SEC's public disclosure website. A firm is also required to post the current version of its relationship summary on its website (if it has one) and make a copy available to any person who requests a copy, at no charge. Firms are required to include a phone number for retail investors to call to request a copy of the relationship summary.²²

A copy of the initial Form CRS must be delivered to all retail investors of each registered broker-dealer and investment adviser within 30 days after filing with the SEC. Thereafter, firms must deliver a Form CRS to each new retail investor and to each existing retail investor in connection with opening a new account type, recommending a rollover of assets, or recommending or providing a new brokerage or investment advisory service or strategy. Delivery of Form CRS may be

²⁰ The disclosure must describe indirect fees and costs, such as custodial fees, fees related to mutual funds and variable annuities and product-level fees, such as those associated with distribution, shareholder servicing and sub-transfer agency fees. *Id.* at 129-130.

²¹ *Id.* at 1.

²² If a firm does not already have a toll-free telephone number, it will not be required to obtain one in order to comply with the requirements of Form CRS. *Id.* at 183.

Form CRS Relationship Summary and Amendments to Form ADV

made through electronic means, consistent with the SEC's existing guidance on electronic delivery.²³ If Form CRS is included in a package of documents, such as a monthly statement, it must be the first document in the package.

Firms must update their relationship summaries when the disclosure becomes materially inaccurate. Copies of the amended Form CRS must be delivered to retail investors within 60 days after the amendments are required to be made.²⁴ Amendments must include an exhibit showing the revisions or summarizing the material changes. Delivery of a relationship summary will not necessarily satisfy other disclosure obligations to which a firm is subject under federal securities laws or other laws or regulations, such as disclosure required by Reg. BI.

Recordkeeping and Retention Requirements

Broker-dealers are required to maintain, for six years, records of the date that Form CRS was delivered to retail investors, as well as copies of the applicable Form CRS itself. Records must be maintained in accordance with Rules 17a-3 and 17a-4 under the Exchange Act. Investment advisers are required to maintain copies of Form CRS in accordance with Rule 204-2 under the Advisers Act.

Liability Standard; No Private Right of Action

Firms must ensure that the information contained in the relationship summary is accurate and complete and does not omit material facts necessary in order to make the disclosures, in light of the circumstances under which they were made, not misleading.²⁵ The liability appears to apply regardless of whether the broker-dealer or investment adviser acted negligently or willfully. Investors do not have a private right of action against firms in respect to the disclosure in Form CRS.

Compliance Dates

Firms that are registered as broker-dealers and/or investment advisers must file a Form CRS with the SEC no later than June 30, 2020 and may make the initial filing with the SEC no earlier than May 1, 2020.

²³ 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, Exchange Act Release No. 37182 (May 9, 1996) [61 FR 24644 (May 15, 1996)], which provides that valid electronic delivery requires: (i) notice to the investor that information is available electronically; (ii) access to information comparable to that which would have been provided in paper form and that is not so burdensome that the intended recipients cannot effectively access it; and (iii) evidence to show delivery, *i.e.*, reason to believe that electronically delivered information will result in the satisfaction of the delivery requirements under the federal securities laws.

²⁴ Broker-dealers and investment advisers must post to their websites and file with the SEC an amended relationship summary within 30 days of the time at which any information in the relationship summary becomes materially inaccurate.

²⁵ *Id.* at 42.

Form CRS Relationship Summary and Amendments to Form ADV

On and after June 30, 2020, firms with a pending broker-dealer application will be required to file Form CRS no later than the date their broker-dealer registration becomes effective. Entities with a pending application for registration with the SEC as an investment adviser must file Form CRS before June 30, 2020 or, if submitted to the SEC after that date, must include Form CRS as Part 3 of the applicant's Form ADV if the applicant will have retail investor clients.

Next Steps

In preparing for compliance with the new rules, broker-dealers and investment advisers first need to identify whether they have customers that are retail investors. Given the breadth of the SEC's definition, which includes individual investors regardless of wealth and covers services such as trade execution even when no recommendation was made to the investor, our expectation is that many firms that are primarily institutional will be required to prepare, file and deliver Form CRS. Firms will also need to develop policies and procedures around the required disclosures, appoint personnel to answer questions about the disclosures, include Form CRS on the firm's website, train financial professionals regarding responses to conversation starters, and ensure compliance with the applicable recordkeeping requirements.

Given recent passage of an amendment to an appropriations bill by the U.S. House of Representatives, it is possible that implementation of the rule will be delayed or stopped altogether. However, based on supportive statements by key members of the Senate regarding Reg. BI and the accompanying rules, such as those relating to Form CRS, there are good reasons to believe that the SEC will implement the rules as scheduled and firms should be prepared to do so.

As you begin to address the impact to your business of complying with these new rules, please reach out to your relationship lawyers at Willkie Farr & Gallagher to assist with the planning.

Form CRS Relationship Summary and Amendments to Form ADV

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