Blogs
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Asset Management ADVocate

The SEC’s Fiduciary Rule Proposal — Implications for Investment Advisers (Part 3)

Welcome back for Part 3 of our discussion of the SEC's April 18, 2018, fiduciary rulemaking proposal (the "Proposal"). Here, we dive into the SEC's proposed Form CRS Relationship Summary and its proposed amendments to Form ADV. We also discuss the proposed rulemaking to restrict broker?dealers' use of the term "adviser" and variations thereof.

Form CRS - the Relationship Summary

The Proposal introduces the Form CRS relationship summary (the "CRS") as a new four-page disclosure document for broker?dealers, investment advisers, and dually-registered firms intended to provide retail investors a more user-friendly explanation of their relationships with advisory and brokerage firms. "Retail investors" would be defined as natural persons and "a trust or other similar entity that represents natural persons." The SEC also proposed a two-page "tear sheet" that would educate retail investors on the CRS. *General Requirements.* The CRS must comply with the Form's instructions and provide disclosure about a range of topics, including:

- The registration status of the firm and its financial professionals and services offered and, in plain English, what the differences entail;
- The types of expenses associated with the firm's and its professionals' services;
- Legal duties to the retail customer;
- Conflicts of interest;
- The disciplinary history of the firm and its financial professionals;
- Avenues for retail investors to report problems; and
- Additional questions retail investors should ask their financial professional.

Dual-Registrants. Dually-registered adviser/broker?dealers would be required to present side?by?side comparative information to inform retail investors entering into advisory and/or broker?dealer relationships. Financial professionals registered in more than one capacity would have to make CRS disclosures only in the capacities in which they provide recommendations to retail investors. *Relationship Summary Templates.* The SEC provided "mock-ups" of the CRS as guideposts:

- Broker-Dealer Mock-up
- Investment Adviser Mock-up
- Dual-Registrant Mock-up

Delivery, Filing, Updating and Recordkeeping.

- Delivery - A firm would deliver the CRS to retail investors (i) for advisers, before or at the time of entering the investment advisory agreement, or (ii) for broker-dealers, before or at the time the investor first engages the firm's services (including placing an order or opening an account). Dual-registrants would deliver the CRS at the earlier of these two events.

- Filing - Each CRS would be filed electronically with the SEC, with (i) advisers filing Form CRS as a new Part 3 to Form ADV through IARD, and (ii) broker-dealers filing Form CRS electronically via EDGAR in a text-searchable format. Dual-registrants would file on EDGAR and IARD.
- Updating - All filers would update the CRS within 30 days of any material change and communicate it to retail customers. This includes material changes to "the nature and scope" of the adviser's relationship a retail investor, including any recommendation made outside "the normal, customary, or already agreed course of dealing" to switch from an advisory account to a brokerage account (or vice versa) or to move assets from one type of account to another.
- Recordkeeping - Firms would be required to retain copies of the CRS, and additionally make and preserve a record of dates on which each CRS was delivered to any client or prospective client who subsequently becomes a client (advisers for five years, broker-dealers for six).
- Compliance - Firms would need to prepare the CRS and comply with the provisions of the Proposal within six months after the eventual effective date.

Restrictions on the Use of Certain Names/Titles and Required Disclosures

The SEC asserts that broker?dealers often use terms such as "financial adviser" or "financial advisor," which appear similar enough to the term "adviser" used by registered investment advisers, that retail investors may reasonably confuse their broker-dealer with a full-service investment adviser (with or without noticing the spelling difference). Noting the substantive differences between investment advisory and brokerage services, the SEC proposed to restrict the use of the terms "adviser" and "advisor" by broker?dealers except when using the terms on behalf of a bank, insurance company, municipal advisor, or commodity trading advisor. Concerns were noted at the open meeting on the Proposal that:

- Broker-dealers may skirt the issue by referring to themselves as "retirement professionals," "investment professionals," "financial consultants," etc.
- The proposed "holding out" standard could potentially conflict with various practices currently permissible under Section 202(a)(11)(C) of the Advisers Act, which allows a broker-dealer to engage in advisory activities that are "solely incidental" to its services as a broker-dealer.

Part 4 of this Blog

Stay tuned for Part 4 of this blog, our final post on the Proposal for now, where we will discuss Regulation Best Interest and some of the key questions already raised regarding the proposal (including a not-so-subtle jab by some Commissioners in referring to it as "Regulation Status Quo"). Until then….

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