Chapman and Cutler LLP

Chapman Client Alert

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Current Issues Relevant to Our Clients

SEC Proposes Form CRS and Title Restrictions

The Securities and Exchange Commission (the "SEC") recently proposed new and amended rules and forms under the Investment Advisers Act of 1940 (the "Advisers Act") and the Securities Exchange Act of 1934 (the "Exchange Act") to require registered investment advisers and broker-dealers to provide a brief relationship summary to retail investors regarding their offered services, the standard of conduct and fees associated with the services ("Form CRS"). The SEC also is proposing new rules under the Exchange Act and Advisers Act that would restrict broker-dealers and associated persons of broker-dealers, when communicating with retail investors, from using the term "adviser" or "advisor" in specified circumstances (the "Title Restrictions"). The full text of the proposal, including instructions on how to submit comments on the proposal is available here.

Simultaneous with its Form CRS and Title Restrictions proposals, the Commission also proposed the following:

1. Proposed Regulation Best Interest—The proposed regulation, if adopted, would establish a federal standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, which is described in our Client Alert available here.

2. Interpretation Regarding Standard of Conduct for Investment Advisers—An interpretation of the standard of conduct for investment advisers, which is described in our Client Alert available here.

Form CRS

Form CRS is a relationship summary that will be required to be delivered to retail investors by registered investment advisers and broker-dealers. Retail investors would be defined as a prospective or existing individual client or customer. For registered investment advisers, initial delivery of Form CRS would be required before or at the time the investment adviser enters in an investment advisory agreement with the retail investor. For registered broker-dealers, initial delivery of Form CRS would be required before or at the time the retail investor first engages the broker-dealer's services. For dual registrants, delivery would be required at the earlier of entering into an investment advisory agreement with the retail investor or the investor first engaging the firm's services. Form CRS would be required to be written in "plain language" and is limited to four pages in length. Form CRS will be required to contain eight sections: (i) introduction; (ii) the relationships and services the firm offers to retail investors; (iii) the standard of conduct applicable to those services; (iv) the fees and costs that retail investors will pay; (v) comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers); (vi) conflicts of interest; (vii) where to find additional information; and (viii) key questions.

Introduction

The introductory section of Form CRS would be required to include a title which highlights the types of investment services and accounts offered by the firm as well as the firm's name, whether it is registered with the SEC as a broker-dealer, investment adviser, or both, and the date of the relationship summary. The introductory section is intended to set up the key theme of the relationship summary, to assist retail investors in understanding their options.

Relationship and Services

The relationship and services section would require a firm to describe the nature, scope and duration of its relationship to retail investors through a combination of prescribed language and the firm's own narrative. This would include the types of accounts and services the firm offers, how often it offers investment advice, whether it offers discretionary advice and whether the firm monitors the accounts. This section also will

include any limitations on the types of investments offered to retail investors including if the firm only offers proprietary products of the firm or its affiliates.

Obligations to Retail Investors

The obligations to retail investors section would require firms to describe their legal standard of conduct toward retail investors. This would include specific prescribed language applicable to broker-dealers, investment advisers and dual registrants (whether "best interest," "fiduciary" or other) as well as the firm's own narrative and the potential for conflicts of interest.

Summary of Fees and Costs

The summary of fees and costs section would require firms to include an overview of specified types of fees and expenses that retail investors will pay in connection with their brokerage and investment advisory accounts. This would include a description of the principal type of fees that the firm will charge, including whether the fees vary or are negotiable, and the key factors that would help a retail investor understand the fees that he or she is likely to pay. This disclosure will be enhanced for dual registrants who may provide both brokerage and advisory services to retail clients. The SEC stopped short and did not propose a requirement that firms personalize the fee disclosure as part of Form CRS.

Comparisons

The comparisons section would require stand-alone investment advisers and stand-alone broker-dealers to include information comparing their services to those offered by broker-dealers or investment advisors, respectively. Stand-alone investment advisers and broker-dealers would include information about generalized broker-dealers or investment advisers, respectively, including: (i) the principal type of fee for services; (ii) services generally provided; (iii) the standard of conduct; and (iv) incentives based on an advisers asset-based fee-structure. The comparisons section also would require a tabular chart which would give a side-by-side comparison of certain specified characteristics of a transaction-based and ongoing asset-based fee.

Conflicts of Interest

The conflicts of interest section would require firms to summarize their conflicts of interest relating to certain financial incentives. Specifically firms would be required to disclose conflicts relating to: (i) financial incentives to offer or recommend that a retail investor invest in certain investments because (a) they are issued, sponsored or managed by the firm or its affiliates, (b) third parties compensate the firm when it recommends or sells the investments, or (c) both; (ii) financial incentives to offer or recommend that a retail investor invest in certain investments because the manager or sponsor of those investments or another third party shares revenue it earns on those products with the firm; and (iii) the firm buying investments from and selling investments to a retail investor for the firm's own account, as principal. This conflicts of interest disclosure is in addition to an investment advisers requirements under Form ADV Part 2 and the proposed disclosures of a broker-dealer under proposed Regulation Best Interest.

Additional Information

The additional information section would require that firms include information on where investors can get information regarding the firm's disciplinary events, services, fees and conflicts. Specifically, firms would be required to disclose whether they or their financial professionals currently disclose or are required to disclose certain legal or disciplinary events to the SEC, any self-regulatory organization, state securities regulators or other applicable jurisdictions.

Key Questions

The key questions section would require firms to include ten prescribed questions, as applicable, to the end of Form CRS for retail investors to ask their financial professionals. Firms may modify or omit portions of the questions as applicable to their business and specific proposals for robo-advisers.

The SEC has drafted examples of what the relationship summaries might look like for a stand-alone broker dealer here, a stand-alone investment adviser here and a dual registrant here.

Title Restrictions

The SEC is also proposing to restrict broker-dealers, and any associated person of such broker-dealer, from using the words "adviser" or "advisor" as part of their name or title when communicating with retail investors, unless such broker or dealer is registered as an investment adviser under the Advisers Act or with a state, or the associated person is a supervised person of an investment adviser registered under the Advisers Act. The proposal would only restrict brokers and dealers from using the terms "adviser" or "advisor" when communicating with retail investors. The Title Restrictions would not restrict broker-dealers, or their associated persons, from using the terms when communicating with institutions.

The rule would also not apply when broker-dealers are acting on behalf of a bank or insurance company, or when acting on behalf of a registered municipal advisor or a commodity trading advisor.

Dual registrants may continue to use the terms “advisor” or “adviser” in their name or title but an associated person of a dual registrant could only use those terms if such person was a supervised person of a registered investment adviser and provides investment advice on behalf of such investment adviser. Under the proposed Title Restrictions a firm would also be required to prominently disclose that it is registered as a broker-dealer or investment adviser, as applicable, in communications with retail investors.

Comment Period

Comments on proposed Form CRS and the Title Restrictions and the other Commission proposals are due by ninety days from the date of their publication in the Federal Register.

For More Information

If you would like to discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

Chapman and Cutler LLP

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