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Compliance Review

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Advisor Services

IN THIS ISSUE

Practical guidance for complying with new Form CRS requirements

Kelli A. Haugh, Managing Director, Foreside

I. Introduction

Effective June 30, 2020, investment advisors and broker-dealers registered with the Securities and Exchange Commission ("SEC") will be required to prepare and deliver a client relationship summary ("Form CRS") that provides information about their investment-related services and fees. The SEC adopted Form CRS on June 5, 2019, along with related rules and rule amendments under the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934, including Regulation Best Interest.[1] This white paper focuses specifically on Form CRS as it applies to investment advisors.

The disclosure requirements under Form CRS (also called Form ADV Part 3 for investment advisors) are in addition to existing Form ADV Part 1 and Part 2 disclosure obligations. The purpose of Form CRS is to reduce confusion for retail investors and assist them when deciding whether to:

- Establish an investment advisory relationship
- Engage a particular firm or financial professional
- Terminate or switch a relationship or specific service

The SEC's expectation is that Form CRS will be a primary document that retail investors will use to decide whether an investment advisory or a brokerage account relationship is best in light of services and fees, and other factors, and to comparison shop among firms. So firms would do well to think of Form CRS as a key client and prospect communication, and not just a regulatory disclosure.

There are many interpretation and implementation issues that firms are grappling with. This white paper is intended to be one resource for firms in addressing those issues. Keep in mind that the SEC has promised to issue FAQs on a rolling basis to assist the industry in addressing many of the questions that have already arisen. Firms should check the SEC website periodically for that updated guidance.

II. Who must file Form CRS?

The requirement to prepare and file Form CRS applies to SEC-registered firms that offer services to retail investors. A retail investor is defined as "a natural person, or the legal representative of such natural person, who seeks or receives services primarily for personal, family, or household purposes."[2] Therefore, an investment advisor who provides or offers investment advisory services solely to institutional clients, such as pooled investment vehicles and registered or private funds, will not have to prepare and deliver Form CRS. The requirement also does not apply to investment

[1] See U.S. Securities and Exchange Commission, Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019); U.S. Securities and Exchange Commission, Regulation Best Interest: The Broker-Dealer Standard of Conduct, File No. S7-07-18 (June 5, 2019).

[2] See Form CRS Instructions, at 9.

advisors whose only clients are pension plans if the firm does not separately provide investment advisory services to plan participants. Notably, net worth is not relevant to the definition of retail investor, so all individuals to whom the firm provides investment advisory services are considered retail investors.

At this time, state regulators have not yet adopted the SEC's Form CRS; therefore, state-registered investment advisors do not need to comply with Form CRS requirements. However, they should nonetheless consider familiarizing themselves with Form CRS content. Since prospective clients may be reviewing the Form CRS of advisors' SEC-registered competitors, state-registered advisors should be prepared to respond to prospective clients' questions that may be prompted by Form CRS.

The requirement to prepare and file Form CRS applies to SEC-registered firms that offer services to retail investors.

III. Filing and delivery requirements

Initial filing and delivery

Investment advisors must file Form CRS by June 30, 2020, via the Investment Adviser Registration Depository ("IARD"). The IARD system will begin allowing firms to file Form CRS as early as May 1, 2020. Although firms may prepare Form CRS earlier, they will not be able to file it prior to May 1 because the IARD system will not have the capability to accept Form CRS filings until then.

Investment advisors must deliver Form CRS to their existing retail investor clients by July 30, 2020, which is within 30 days after the date they are required to initially file Form CRS. Effective June 30, 2020, firms must start delivering Form CRS to new and prospective clients before or at the time of entering into a new investment contract with the retail investor. The filing and delivery deadlines apply to all SEC-registered advisors providing or offering services to retail investors regardless of fiscal year-end.

Notably, investment advisors with a December 31 fiscal year-end will not be able to combine their initial Form CRS filing with their 2020 Form ADV Annual Updating Amendment filing since the Annual Updating Amendment filings for these firms are due by March 30, 2020 (within 90 days of fiscal year-end). Additionally, since material changes to a firm's Form ADV Part 2 disclosure brochure must be delivered to clients within 120 days of the firm's fiscal year-end, firms with a December 31 fiscal year-end will need to deliver their summary of material changes (if any) to clients by April 29, 2020, in advance of the Form CRS filing. Thus, these firms will deliver their summary of material changes and Form CRS separately.

Amendments and interim delivery

Form CRS is required to be updated and filed with the SEC within 30 days of when any information in the summary becomes materially inaccurate. This 30-day time period generally corresponds to Form ADV Part 2 updating requirements; however, Form ADV Part 2 is technically required to be updated "promptly" whenever information in the Part 2 becomes materially inaccurate.[3] Although "promptly" has typically been interpreted to mean within 30 days, the SEC has specifically mandated a 30-day time period for Form CRS rather than adopt the "promptly" standard applicable to Form ADV Part 2, which adds clarification around the updating requirements. Unlike current Form ADV requirements (which require at least an annual update), Form CRS is not required to be updated absent material changes to the summary.

When submitting a Form CRS amendment filing, the filing must include an attached exhibit highlighting the changes. Firms can denote the changes by marking the revised text or preparing a summary of material changes.

Firms are required to deliver Form CRS to clients upon the occurrence of any of the following:

- Any time the firm opens a new account that is different from the client's existing account(s)
- When the firm recommends that the client roll over assets from a retirement account, including a 401(k) plan, into a new or existing account or investment
- When the firm 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
- Within 30 days of a client's request to receive Form CRS
- Within 60 days of making a material amendment to Form CRS

Communication of changes to Form CRS may be done independently or can be combined with the delivery of other communications to clients.

It should be noted that while a firm is required to deliver Form CRS when it opens a new account for a client that is different from the client's existing account, what constitutes "different" has not yet been specifically defined. It can be interpreted to mean an account type that is different from the client's existing account type (e.g., a non-retirement account vs. a retirement account such as an IRA); however, the SEC[4] may offer additional insight on its interpretation of that term as it continues to publish guidance on Form CRS.

[3] See Form ADV Part 2 Instructions, Question 4.

[4] See the SEC's Frequently Asked Questions on Form CRS, which is periodically updated.

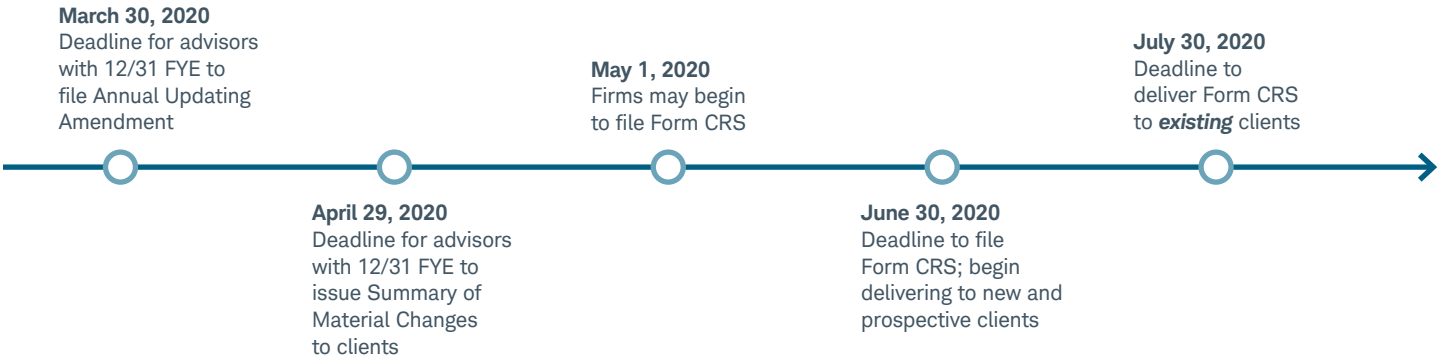
Methods of delivery

Like the Form ADV Part 2 disclosure brochure, firms may deliver Form CRS either in hard copy or electronic format. If Form CRS is delivered in hard copy, it must appear first among any documents that are delivered at that time.

If firms deliver Form CRS electronically, they must adhere to the SEC's guidelines regarding electronic delivery of disclosure documents set forth in its "Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information" interpretive guidance, which includes considerations such as providing notice to clients regarding electronic delivery, ensuring clients have access to the electronic documents, evidencing delivery, and safeguarding personal client information.[5] Additionally, Form CRS must be presented prominently—e.g., via a direct link or in the body of an email or message—and must be easily accessible by the recipient.

Firms must also post their current Form CRS prominently on their public websites, if they have one. The form must be easily accessible and must provide a means to electronically access any information that is referenced in Form CRS, such as the firm's Form ADV Part 2 disclosure brochure, if the information is available online. Note that merely posting Form CRS to a website will not satisfy a firm's delivery requirements, as posting alone does not meet the electronic delivery requirements set forth in the SEC's "Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information" interpretive guidance.

Timeline for Form CRS filing and delivery



Form CRS filing and amendment requirements

Initial filing

- May 1, 2020: Firms may begin filing via IARD
- June 30, 2020: Filing deadline

Initial delivery to existing clients

- July 30, 2020: Delivery deadline

Delivery to new and prospective clients

- Begin on June 30, 2020
- Deliver before or at the time of entering into a new advisory contract

Amendment filings

- Within 30 days of when any information becomes materially inaccurate

Delivery to existing clients (other than initial delivery)

- Any time the firm opens a new account that is different from the client's existing account(s)
- When the firm recommends that the client roll over assets from a retirement account into a new or existing account or investment
- When the firm 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
- Within 30 days of a client's request to receive Form CRS
- Within 60 days of making a material amendment to Form CRS

[5] See U.S. Securities and Exchange Commission, Release No. IA-1532 (May 9, 1996).

IV. General format and content requirements

The 17 pages of Form CRS instructions are detailed and somewhat complex. Firms should directly rely on those instructions and appoint a firm expert on them. As noted previously, this white paper is intended to be one resource for firms.

The SEC intended Form CRS to be a concise summary and has therefore imposed a two-page limit. Firms that are dually registered as investment advisors and broker-dealers, and provide both advisory and brokerage services to retail clients, may use a single Form CRS with a four-page limit. Dual registrants may use a side-by-side comparison chart for their brokerage and investment advisory accounts, or a separate two-page Form CRS for brokerage relationships that is attached to and always accompanies a separate two-page Form CRS for advisory relationships. The SEC staff has indicated that all advisory accounts and programs must be discussed on one Form CRS. In other words, firms with multiple and distinct advisory programs may not create a separate Form CRS for each program, whether or not particular clients qualify for some but not all of the programs. Form CRS is also required to be written in "plain English" format, consistent with Form ADV Part 2 requirements. The Form CRS instructions describe the following as characteristics of plain English format:

- Short sentences and paragraphs
- Definite, concrete, everyday words
- Active voice
- No legal jargon or highly technical business terms unless they are clearly explained
- No multiple negatives

Firms must also write responses in first person as though they are speaking directly to the client, using "you," "us," and "our firm." For additional guidance on writing in plain English, refer to the SEC's Plain English Handbook.[6]

Firms are also encouraged to use visual aids to help enhance the client's understanding of the information in the summary, including charts, graphs, tables, illustrations, fee calculators, and means of accessing video or audio messages. Like the content standards of Form ADV, the summary must be accurate, must not be misleading, and must include all material facts responsive to the Form CRS instructions. As described in more detail throughout this paper, the SEC will allow (and practically speaking, firms will need to use) a layered disclosure approach that includes links to additional information, most if not all of which may be in Form ADV Part 2.

"Conversation Starters" are a key part of Form CRS. The SEC intends these to serve as cues for retail investors to probe firms about their business practices. As outlined later in this paper, Conversation Starters are set forth under each of the relevant Items in the Form. For a digital Form CRS, firms may want to consider a mouse-over or link that actually provides well-considered, uniform answers to those questions that representatives would also be trained to discuss with clients or prospective clients.

Form CRS must also be filed using a text-searchable format with machine-readable headings. For guidance on how to create machine-readable headings, see the SEC's FAQs on Form CRS.[7]

The instructions to Form CRS are organized by the following topic items, which are more fully described in the next section.[8]

Item 1: Introduction

Item 2: Relationships and Services

Item 3: Fees, Costs, Conflicts, and Standard of Conduct

Item 4: Disciplinary History

Item 5: Additional Information

Under each item, Form CRS mandates specific headings that are presented as questions and cannot be modified. Firms are not required to identify each item number in their Form CRS; however, all subject headings must be included. The Form also mandates standard "Conversation Starters," which are questions that clients are encouraged to ask. The Conversation Starters are intended to facilitate a discussion between firms and their clients, and they must incorporate text features to make them more prominent and noticeable in relation to the other text in Form CRS. Firms may omit or modify Conversation Starters in limited circumstances where including the language as written would be misleading or inaccurate in the context of a firm's business model. There are also instances where certain mandatory language is required; however, there is also ample opportunity for firms to use their own wording to describe their services, fees, conflicts, and other required disclosures.

Form CRS formatting and content highlights

- ✓ Two-page maximum (four pages for dual registrants)
- ✓ Plain English format
- ✓ Charts, graphs, text features encouraged
- ✓ Specified format organized by five topics
- ✓ Combination of prescribed language and firm-specific wording
- ✓ Conversation Starters

[6] A Plain English Handbook: How to create clear SEC disclosure documents (August 1998).

[7] Frequently Asked Questions on Form CRS (Modified November 26, 2019).

[8] See U.S. Securities and Exchange Commission, Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019).

V. Preparing Form CRS

Item 1: Introduction

The beginning of Form CRS will include basic information about the firm, such as the firm's name and whether the firm is registered with the SEC as an investment advisor, broker-dealer, or both. Firms must include a statement that brokerage and investment advisory services and fees are different and that it is important for the retail investor to understand the differences. Firms must also provide a link to Investor.gov/CRS, which is an SEC-sponsored website that provides educational information about investment advisors, broker-dealers, and investing. It describes what Form CRS is and why retail investors should read it. The website also contains videos that describe, generally, the differences between investment advisors and broker-dealers and how they get paid.

TIP:

Firms should consider familiarizing themselves with the Investor.gov/CRS website in the event that clients have questions regarding the information presented on the website.

Item 2: Relationships and Services

"What investment services and advice can you provide me?"

Under this heading, investment advisors are required to:

- State that they offer investment advisory services to retail clients (or both investment advisory and brokerage services in the case of dually registered firms[9])
- Summarize the principal services, accounts, or investments made available to retail investors, including the limitations
- State the particular types of principal investment advisory services offered to retail investors, including financial planning and wrap fee programs

Additionally, the firm's description must (1) address whether and how often the firm monitors investments and whether those services are part of the firm's standard services, (2) describe services over which they exercise investment discretion, (3) explain that the retail investor makes the ultimate decision regarding the purchase or sale of investments if the firm offers non-discretionary services, (4) explain whether the firm makes available or offers advice only with respect to proprietary or limited investment offerings (including a description of such limitations), and (5) explain whether the firm imposes any requirements to open or maintain accounts such as minimum account sizes or investment amounts. This is also the section where firms can carefully describe what fiduciary services it provides, which distinguishes most RIAs from brokerage firms. Firms are not allowed to use the term "fiduciary" under Item 3, covered later in the paper, when describing the standard of conduct that applies.

Specific references to more detailed information about the firm's services that includes the same or equivalent information as required by Form ADV Part 2 (Part 2A and Appendix 1, if applicable) must be incorporated under this heading. Firms can include hyperlinks, mouse-over windows, or any other means to facilitate access to the additional information.

Conversation Starters:

- *"Given my financial situation, should I choose an investment advisory service? Why or why not?"*[10]
- *"How will you choose investments to recommend to me?"*
- *"What is your relevant experience, including your licenses, education, and other qualifications? What do these qualifications mean?"*

TIPS:

- Since Form CRS applies to retail investors only, the services described within this section should reflect only those provided to retail investors. Thus, services provided to institutional and other non-retail investors should not be covered in the Form CRS narrative.
- Although the disclosures required by Form CRS and Form ADV Part 2 are similar, in some instances, they are not identical and therefore warrant further explanation in Form CRS. For example, Item 13 of Form ADV Part 2A requires firms to indicate whether they periodically review client accounts, whereas Form CRS requires an explanation as to whether accounts are monitored. Since "reviewing" accounts may not be the same as "monitoring" investments, depending on the firm's specific service model, merely cross-referencing Item 13 of Part 2A or copying the language under that item may not be responsive to Form CRS. That said, language contained in Form ADV Part 2A and Form CRS should be consistent.

[9] Only dually registered investment advisors/broker-dealers who provide or offer both investment advisory and brokerage services to retail clients are considered "dual registrants" for the purpose of Form CRS compliance. Accordingly, a firm that is dually registered, but offers only advisory services to retail clients would need to prepare, file and deliver Form CRS only in accordance with the obligations of an investment advisor and not a broker-dealer. Id. at 68. On the other hand, a firm that has a BD affiliate and/or whose representatives may provide both brokerage and advisory account recommendations is required to deliver both its own and its affiliate's Forms CRS to a client or prospective client.

[10] For dual registrants, this Conversation Starter would be replaced with "Given my financial situation, should I choose an investment advisory service? Should I choose a brokerage service? Should I choose both types of services? Why or why not?" See Form CRS Instructions at 11.

- Advisors who do not monitor client accounts should consider explaining why they do not monitor investments even though such an explanation is not specifically required by Form CRS. In its interpretive guidance on investment advisors' fiduciary duty, the SEC stated that monitoring is included in investment advisors' duty of care; however, when an advisor and the client have a relationship of limited duration such as one-time financial planning, there is unlikely a duty to monitor.[11] Since firms must state that they do not provide monitoring if that is in fact the case, providing a rationale as to why monitoring is not applicable (e.g., monitoring may be outside the limited scope of services provided by the firm) may offer context in light of the advisor's fiduciary duty.
- Although cross-references to Form ADV Part 2A may be made via a hyperlink or other electronic means, firms that will provide their Form CRS in hard copy should spell out URL addresses for electronic cross-references to facilitate access to the cross-referenced material.
- The text design of cross-references must be more noticeable to distinguish them from other discussion text.

Item 3: Fees, Costs, Conflicts, and Standard of Conduct

"What fees will I pay?"

Under this first of three headings, firms are required to summarize the principal fees and costs that retail investors incur for their services, how frequently they are assessed, and the conflicts of interest they create. Investment advisors must describe their ongoing asset-based fees, fixed fees, wrap program fees, or other direct fee arrangements. Importantly, Form CRS does not require firms to include their specific fee schedules. Firms need only provide an overview of the types of fees charged.

The principal fees should align with the types of fees reported on the firm's Form ADV Part 1A, Item 5.E.[12] Additionally, each type of fee described should include corresponding conflict-of-interest disclosure. As an example, the Form CRS instructions state that an investment advisor charging an asset-based fee could describe, as a conflict of interest, that "the more assets there are in a retail investor's advisory account, the more a retail investor will pay in fees, and the firm may therefore have an incentive to encourage the retail investor to increase the assets in his or her account."[13]

Investment advisors with wrap fee programs should further explain that the asset-based fees associated with the wrap program include most transaction costs and fees to a broker-dealer or custodian and the asset-based fee is therefore higher than a typical asset-based advisory fee. These advisors should also include disclosure about the program, including relevant fees and conflicts of interest.[14] Investment advisors are also required to describe other fees and costs related to their advisory services that are in addition to the firm's principal fees and costs. Firms are required to list the most common types of fees and costs, including:

- Custodian fees
- Account maintenance fees
- Fees related to mutual funds and variable annuities
- Other transactional fees and product-level fees

Recognizing that the fees and costs considered most common will vary and depend on the particular products and services a firm offers, the SEC stated that in making this determination, firms should consider the following:[15]

- The amount of the fee (including whether the fee varies based on options that the investor selects)
- The likelihood that the fee will be applicable
- Whether the fee is ordinarily assessed on a significant number of the firm's clients
- Whether the fee is associated with a product or service that the firm frequently recommends or provides
- Whether the fee is contingent upon certain events the investor should be made aware of
- The effect on returns
- The magnitude of the conflict of interest it may create

Looking for more information on compliance or regulatory issues?

Schwab's compliance website includes a searchable database, compliance tools, and many other resources to assist you. Visit schwabadvisorcenter.com > News & Resources > Compliance. (See "Online compliance resources" on back page for more information.)

[11] See Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (July 12, 2019) at 20.

[12] See Form ADV Part 1A, Item 5.E., "Compensation Arrangements".

[13] See Form CRS Instructions at 12.

[14] U.S. Securities and Exchange Commission, Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019) at 126.

[15] Id. at 130.

Considering the aforementioned factors, commissions are an example of an additional cost advisors should disclose. Firms are also required to state specifically the following under this heading:

"You will pay fees and costs whether you make or lose money on your investments. Fees and costs will reduce any amount of money you make on your investments over time. Please make sure you understand what fees and costs you are paying."

Firms are also required to cross-reference the more detailed information about their services and fees required by Items 5.A., B., C., and D. of Form ADV Part 2A.[16] Again, firms can include hyperlinks, mouse-over windows, or any other means to facilitate access to the additional information.

Conversation Starter:

- *"Help me understand how these fees and costs might affect my investments. If I give you $10,000 to invest, how much will go to fees and costs, and how much will be invested for me?"*

TIPS:

- Considering that firms must account for all fee types reported in their Form ADV Part 1A filings and cross-reference their Form ADV Part 2 fee disclosures, firms should review their Form ADV disclosures to ensure they are accurate and consistent among the various applicable sections of the Form ADV (e.g., Item 5.E. of Part 1A and Items 5.A., B., C., and D. of Form ADV Part 2A). Firms should consider updating their Form ADV disclosures to address any inaccuracies or inconsistencies prior to filing Form CRS to ensure that any cross-references to Form ADV disclosures accurately represent the firm's fees.
- In preparing conflict-of-interest disclosures related to advisory fees and costs, firms should consider conflicts from a retail investor's perspective even if the firm believes the conflicts are mitigated. For example, a firm may not consider asset-based fees to create conflicts of interest, particularly where neither the firm nor any of its associated persons earn any additional compensation. However, as the SEC pointed out as an example in the Form CRS instructions, asset-based fees can present a conflict because they incentivize firms to encourage clients to invest additional funds in their accounts. One example of this is encouraging a client to roll over their 401(k) assets into an account that the advisor can manage and thereby earn an asset-based fee.

"What are your legal obligations to me when acting as my investment adviser? How else does your firm make money and what conflicts of interest do you have?"[17]

Under this heading, standalone investment advisors must include the following prescribed statement regarding the standard of conduct applicable to investment advisors (note that the Form CRS instructions specifically state that the first part of the following prescribed language must be emphasized using a different text feature, hence the bolded text):

"When we act as your investment adviser, *we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the investment advice we provide you. Here are some examples to help you understand what this means."*[18]

Helpful Form CRS resources

For an illustration of what Form CRS prepared by an investment advisor may look like, you can refer to a sample prepared by the Investment Adviser Association ("IAA").

Helpful SEC resources include the following:

Appendix B Form CRS Instructions

SEC FAQs

Form CRS Final Rule

[16] See Form ADV Part 2A Instructions.

[17] A different heading applies to dual registrants preparing a single Form CRS: *"What are your legal obligations to me when providing recommendations as my broker-dealer or when acting as my investment adviser? How else does your firm make money and what conflicts of interest do you have?"* See Form CRS Instructions at 13.

[18] A different statement applies to dual registrants preparing a single Form CRS that provide recommendations subject to Regulation Best Interest. In such cases, the statement will read, *"When we provide you with a recommendation as your broker-dealer or act as your investment adviser, we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations and investment advice we provide you. Here are some examples to help you understand what this means."* Dual registrants that do not provide recommendations subject to Regulation Best Interest will include the following statement: *"We do not provide recommendations as your broker-dealer. When we act as your investment adviser, we have to act in your best interest and not put our interests ahead of yours. At the same time, the way we make money creates some conflicts with your interest. You should understand and ask us about these conflicts because they can affect the services and investment advice we provide you. Here are some examples to help you understand what this means." Id.* at 14.

Notably, the Form CRS instructions do not use the term "fiduciary" to describe the standard of conduct applicable to investment advisors. The SEC refrained from using the term "fiduciary," and used the term "best interest" instead, to avoid investor confusion around the terms applicable to investment advisors, broker-dealers, and dual registrants.[19] Although firms cannot modify the prescribed language, they are permitted to include that term when describing their services under Item 2, discussed previously. Firms must also summarize the following ways in which they or their affiliates make money from brokerage or investment advisory services, and the incentives created from such compensation:

- **Proprietary products**, which are investments that are issued, sponsored, or managed by the firm or its affiliates
- **Third-party payments**, which is compensation firms receive from third parties when they recommend or sell certain investments
- **Revenue sharing**, which are investments where the manager or sponsor of those investments or another third party (such as an intermediary or custodian) shares with the firm revenue it earns on those investments
- **Principal trading**, which are investments a firm buys from a retail investor, and/or investments a firm sells to a retail investor, for or from its own accounts, respectively

If none of the above applies, firms must summarize at least one other material conflict of interest that affects retail investors. The SEC has stated that firms should carefully consider their operations in their entirety when selecting a material conflict to disclose to investors. The SEC also noted its opinion that it is unlikely that a firm will have no material conflicts to disclose. Although, if that is the case, a firm may omit or modify the disclosure.[20] Importantly, firms are not permitted to disclose in Form CRS how conflicts will be mitigated or minimized since the purpose of this section of Form CRS is to highlight for investors that conflicts of interest exist.[21] Those mitigation measures, however, can be included in the answer to the required Conversation Starter, below.

Conversation Starter:

- *"How might your conflicts of interest affect me, and how will you address them?"*

TIPS:

- With the relatively recent emergence of the term "fiduciary" in mainstream news and publications, as well as the information that investors may access on the SEC's Investor.gov/CRS website, clients and prospective clients may now be more likely to consider the relevance of the term. Investment advisors should be prepared to discuss how the fiduciary standard of care applies to their practices. Firms can refer to the SEC's interpretive guidance on the standard of conduct for investment advisors for more information on the specific duties required by a fiduciary standard of conduct.[22]
- While the Form ADV Part 2 instructions require disclosures around compensation and economic benefits, Form CRS is more specific as to the types of compensation that warrant incentive disclosures. For example, while revenue-sharing arrangements would implicitly warrant conflict-of-interest disclosure in Form ADV Part 2, Form CRS has explicitly identified it as a type of arrangement that requires conflict-of-interest disclosure. Accordingly, firms should revisit their Form ADV Part 2 disclosure brochure(s) to ensure that all conflicts of interests are identified and, importantly, that all conflicts identified in Form CRS are also correspondingly disclosed in the firms' Form ADV Part 2.

"How do your financial professionals make money?"

Firms are required to summarize how their financial professionals are compensated, including both cash and non-cash compensation, and the conflicts of interest those payments create. To the extent applicable, firms must include in their summaries whether their financial professionals are compensated based on the following factors:

- The amount of client assets they service
- The time and complexity required to meet a client's needs
- The product sold (i.e., differential compensation)
- Product sales commissions
- Revenue the firm earns from the financial professionals' advisory services or recommendations

[19] U.S. Securities and Exchange Commission, Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019) at 25.

[20] Id. at 157.

[21] Id. at 166.

[22] See Commission Interpretation Regarding Standard of Conduct for Investment Advisers. Release No. IA-5248 (July 12, 2019).

TIP:

Firms should review each supervised person's compensation to account for all compensation structures and to determine whether the type of compensation any individual earns falls within one of the categories listed previously. Additionally, Item 5 of Form ADV Part 2B requires disclosure of additional compensation that a supervised person receives for providing investment advisory services, including sales awards and other prizes as well as bonuses based on the number of sales, client referrals, or new accounts. Therefore, firms should review each of their ADV Part 2Bs to ensure consistency between the Part 2B and Form CRS disclosures.

Item 4: Disciplinary History

"Do you or your financial professionals have legal or disciplinary history?"

Investment advisors are required to simply state "yes" if the firm or any of its financial professionals currently disclose, or are required to disclose, any of the following:

- Disciplinary information in its Form ADV (Item 11 of Part 1A or Item 9 of Part 2A)
- Disclosures for any of its financial professionals in Items 14 A–M on Form U4 (Uniform Application for Securities Industry Registration or Transfer) or in Items 7A or 7C–F of Form U5 (Uniform Termination Notice for Securities Industry Registration)

These disciplinary items include certain criminal and civil actions, administrative proceedings, and self-regulatory organization (SRO) proceedings. If no disciplinary information applies, firms are required to simply state "no." Regardless of how the firm responds, the retail investor must be directed to visit Investor.gov/CRS for a free and simple tool to research the firm or its financial professionals.

Conversation Starter:

- *"As a financial professional, do you have any disciplinary history? For what type of conduct?"*

TIPS:

- Firms are not required to duplicate disciplinary event disclosures under this heading. Responses to the question should be limited to "yes" or "no."
- The disciplinary information required by Form ADV, Form U4, and Form U5 are currently publicly available; however, Form CRS further elevates their prominence. Therefore, it is particularly important to ensure that the information on these forms is accurate, and if not, that it is promptly updated. Firms should also confirm with each of their financial professionals whether they have new or additional disciplinary events to disclose.

Item 5: Additional Information

Firms must state where retail investors can find additional information about the firm's services and where they can request a copy of the firm's Form CRS, including the firm's telephone number at which they may request such information. This information should be disclosed prominently at the end of Form CRS.

Conversation Starter:

- *"Who is my primary contact person? Is he or she a representative of an investment adviser or a broker-dealer? Who can I talk to if I have concerns about how this person is treating me?"*

VI. What can firms do now to prepare for the June 30, 2020, filing deadline?

Although Form CRS is limited to two pages (four pages for dual registrants), preparing for its content requirements may take a significant amount of time. Thus, it's recommended that investment advisors consider taking the following actions to ensure they will meet their Form CRS filing and delivery obligations by the applicable deadlines.

- **Begin preparing responses to each Conversation Starter.** Although firms are not required to prepare written responses to the Conversation Starters, it is important that the firm presents accurate and consistent responses should clients ask questions prompted by the Conversation Starters. Depending on the nature of the question, firms may want to invite investment management, compliance, and marketing staff to collaborate on responses that reflect the firm's actual investment advisory practices and represent the firm's branding and existing marketing materials. Accordingly, it is important that firms allow themselves adequate time to prepare and communicate responses internally.
- **Conduct a comprehensive review of Form ADV.** Since many of the Form CRS discussion topics are related to the Form ADV, firms should review their existing Form ADV disclosures to ensure their accuracy and completeness. This is particularly critical because Form CRS requires firms to cross-reference information required by Form ADV Part 2. Firms should avoid references to stale, inaccurate, or inadequate disclosures. If Form ADV needs to be amended, it is recommended that firms file those amendments promptly. In any event, firms should file the amendments before preparing Form CRS in order to avoid delays in creating and filing Form CRS.
- **Inventory revenue sources and related conflicts of interests.** A significant portion of Form CRS focuses on the disclosure of conflicts of interests, some of which may not have been previously addressed in Form ADV. Thus, firms should start outlining any revenue sources, relationships, or other arrangements that create conflicts of interest. Those conflicts should be disclosed in both Form CRS and Form ADV, as appropriate.

- **Review disciplinary disclosures.** As mentioned previously, Form CRS has elevated the prominence of Form ADV, Form U4, and Form U5 disciplinary disclosures. Therefore, it is particularly important to ensure that disciplinary items are accurately disclosed. Firms that have many financial professionals should consider allowing themselves adequate time to review all individual disclosures and obtain confirmation from those individuals regarding their disciplinary information reporting. Firms may also want to consider whether disciplinary disclosures are eligible for removal.
- **Inventory retail clients for CRS delivery.** Firms should consider whether any of their clients are retail investors, or whether they plan on offering services to retail investors. Firms that are transitioning their business model to institutional-only services prior to the June 30, 2020, filing deadline may find that they do not need to comply with Form CRS. Conversely, firms currently providing services to institutional clients only, but who are planning to offer services to retail clients in the future, will need to plan on complying with Form CRS requirements.

VII. Conclusion

SEC-registered firms that provide investment services to retail investors will be subject to the additional disclosure, filing, and delivery requirements of Form CRS effective June 30, 2020. Additionally, although Form CRS is a mandatory disclosure document, it also presents an opportunity for firms to facilitate further communication with their retail clients. Since the purpose of the relationship summary is to reduce investor confusion regarding the marketplace for investment advisory and brokerage services, firms can use it as a means to highlight their services and practices, and to encourage meaningful discussions about their firms with retail clients and prospective clients. Early preparation is key to implementing a Form CRS that accurately and adequately reflects the firm's practices. With proper planning and advance attention to Form CRS, firms should be in a good position to fold the new compliance requirements into their existing processes.

Online compliance resources

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About the author

Kelli A. Haugh
Managing Director, Foreside

Kelli A. Haugh oversees investment advisory services and provides strategic and regulatory guidance to investment advisors under the Investment Advisers Act of 1940 and state securities laws, working with firms of diverse sizes and complexities. She frequently participates in industry conferences and webinars, speaking on a variety of compliance topics related to investment advisors. Ms. Haugh received her J.D. from Nova Southeastern University Law School and her B.A. from University of Miami. She holds an Accredited Investment Fiduciary® (AIF®) designation and a Certified Securities Compliance Professional® (CSCP®) designation. Ms. Haugh is also a member of the Florida bar and was previously an attorney with Dew, Foxman & Haugh, PLLC, concentrating on corporate and securities law.

Appendix

Form CRS Frequently Asked Questions

1. Who must file Form CRS?

» The requirement to prepare and file Form CRS applies to SEC-registered firms who have clients who are retail investors. It does not currently apply to state-registered investment advisors or advisors who do not have any clients or prospective clients who are retail investors.

2. What is a retail investor?

» A retail investor is defined as "a **natural person**, or the **legal representative** of such natural person, who seeks or receives services primarily for **personal, family, or household purposes**."

The "legal representative" of a natural person covers 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 power of attorney for a natural person).

"Personal, family, or household purposes" includes, for example, retirement, education, and other personal, family, or household saving and investing objectives. Natural persons seeking investment services for commercial or business purposes are not considered retail investors (e.g., where an employee seeks services for an employer or an individual seeks services for a small business or on behalf of another non–natural person entity such as a charitable trust).

Natural persons seeking services for a mix of personal and commercial or other non-personal purposes must be treated as retail investors for the purposes of Form CRS delivery.

There is no minimum net worth requirement to meet the definition of retail investor.

3. When is Form CRS required to be filed?

» Firms that are registered, or have an application pending for registration, with the SEC prior to June 30, 2020, are required to file Form CRS by June 30, 2020. The SEC will not accept initial applications for registration after June 30, 2020, without Form CRS.

4. How soon can Form CRS be filed?

» Form CRS can be filed as early as May 1, 2020. Although firms may prepare Form CRS earlier, they will not be able to file it prior to May 1 because the Investment Adviser Registration Depository (IARD) system will not have the capability to accept Form CRS filings until then.

5. Can Form CRS be delivered electronically?

» Yes, Form CRS may be delivered to clients electronically. However, firms must adhere to the SEC's guidelines regarding electronic delivery of disclosure documents set forth in its "Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information" interpretive guidance. This guidance includes considerations such as providing notice to clients regarding electronic delivery, ensuring that clients have access to the electronic documents, evidencing delivery, and safeguarding personal client information.

6. When does Form CRS need to be updated?

» Form CRS is required to be updated and filed with the SEC within 30 days of when any information in the summary becomes materially inaccurate.

7. Does Form CRS need to be updated annually?

» No, unlike current Form ADV (which requires at least an annual update), Form CRS does not need to be updated annually absent material changes.

8. Subsequent to the initial delivery, when does Form CRS need to be delivered to existing clients?

» Firms are required to deliver Form CRS to clients upon the occurrence of any of the following:

- Any time the firm opens a new account that is different from the client's existing account(s)
- When the firm recommends that the client roll over assets from a retirement account into a new or existing account or investment
- When the firm 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

9. If Form CRS is required to be delivered to existing clients (after the initial delivery), what is the time frame for delivery?

» Firms are required to deliver Form CRS to clients:

- Within 30 days of a client's request to receive Form CRS
- Within 60 days of making a material amendment to Form CRS

10. Can Form CRS be delivered in hard copy along with other client communications?

» Yes; however, Form CRS must be the first among any documents delivered.

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Additional FAQs are available on Foreside's website:
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