

MEMO# 33993

January 13, 2022

Summary of Recent Developments Related to Regulation Best Interest and Form CRS

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TO: Investment Adviser and Broker-Dealer Standards of Conduct Working Group RE:
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This memorandum provides highlights of developments over the past few months related to the SEC's Regulation Best Interest ("Reg BI")[\[1\]](#) and Form CRS,[\[2\]](#) including a recent SEC staff statement regarding the staff's review of Form CRS filings, and a summary of developments relating to Reg BI.

SEC Staff Statement Regarding Form CRS Disclosures

On December 17, 2021, the SEC staff comprising the Standards of Conduct Implementation Committee ("Committee") issued a statement ("Statement") discussing its findings with respect to Form CRS disclosures.[\[3\]](#) The Committee reviewed Form CRS relationship summaries to determine whether the filings were fulfilling their intended purpose. To achieve this, the Committee reviewed relationship summaries filed by a diverse cross-section of firms to see how firms have implemented the content and format requirements of Form CRS. The Committee found some good examples of disclosures, and others where improvements were needed. The Statement suggests that firms may wish to review their relationship summary disclosures in light of the observations summarized below to ensure they conform with Form CRS's requirements. Based on its review, the Committee observed that compliance improvements were needed in the following areas:

- **Use of Technical Language, Including Disclaimers.** The staff found that some firms referenced technical terms such as "riskless principal," "in arrears," "markups," and "markdowns," or cited specific SEC rules without providing clear explanations. Firms must avoid using legal jargon and highly technical terms in their relationship summaries unless the terms are clearly explained. The staff also observed the use of disclosures beyond those permitted by Form CRS, hedging language, and disclaimers in relationship summaries. Firms may only include disclosures required by Form CRS and neither disclaimers nor hedging language is permitted. For example, some firms stated in their relationship summary that the document "does not create or modify

any agreement, relationship or obligation" between the investor and the firm or its financial professionals, which the staff characterized as impermissible hedging language.

- **Omission of Required Information.** The staff observed that some firms omitted in their relationship summaries required disclosures, including headers, prescribed language, and conversation starters related to conflicts of interest, investment authority, monitoring services, and disciplinary history. The staff explained that omissions and modifications of required disclosures or "conversation starters" are permitted only in limited circumstances where: (i) it is inapplicable to the firm's business; or (ii) the specific wording required by the form's instructions would be inaccurate with respect to the firm.
- **Reliance on Instructions in the Proposed Version of Form CRS, rather than the Final Form.** The staff observed that some firms relied on the proposed instructions to Form CRS rather than the final instructions to Form CRS, as adopted by the Commission. For example, the staff observed many firms that used the proposed conversation starters and/or proposed standard of conduct language (i.e., "we are held to a fiduciary standard that covers our entire investment advisory relationship with you") rather than the language the Commission adopted in its final instructions to Form CRS (i.e., "we have to act in your best interest and not put our interest ahead of yours").
- **Lack of Specific References to More Detailed Information.** Firms are required to provide specific references to more detailed information describing the firm's services, fees and costs, and conflicts of interest. At a minimum, a firm must include in its relationship summary the same or equivalent information to that required by Form ADV, Part 2A and Regulation Best Interest, as applicable. Moreover, relationship summaries that appear on a firm's website or otherwise posted electronically "must provide a means of facilitating access to any information referenced in the relationship summary if the information is available online" (i.e., provide direct hyperlinks to Form ADV and Reg BI disclosures to facilitate investors' access to the additional information).
- **Shortcomings in Descriptions of Relationship and Services, and in Descriptions of Fees, Costs, Conflicts, and Standard of Conduct.** The staff noted seven specific areas where it observed shortcomings in relationship summaries' descriptions: (i) monitoring; (ii) investment authority; (iii) limited investment offerings; (iv) principal fees and costs; (v) wrap fee program offerings and fees; (vi) extraneous disclosures regarding standards of conduct; and (vii) firm and financial professional compensation arrangements and conflicts of interest. The Statement provides guidance and examples regarding each of these types of disclosures.
- **Improper Modification and/or Supplementation of the Form's Required Disciplinary History Disclosure.** The staff observed firms omitting or modifying the heading or the conversation starters required by Form CRS relating to disciplinary history or providing extraneous language explaining their response. Firms are required to include the heading "[d]o you or your financial professionals have legal or disciplinary history" in their relationship summaries and the answer is limited to "yes" or "no." Firms may not add a description, qualitative, or quantitative language to their response. Firms are also required to reference the SEC's website, [Investor.gov/CRS](https://www.investor.gov/crs), and included required conversation starters in their relationship summaries.
- **Failure to Prominently Display Relationship Summary on Website.** The staff observed the following issues that contributed to making relationship summaries difficult to locate, including but not limited to: (i) using small or hard to read text in the hyperlink to the relationship summary; (ii) using a non-descriptive term or phrase to label the relationship summary, such as "regulatory disclosures;" (iii) placing the hyperlink to

the relationship summary several pages (clicks) away from the firm's investor homepage; and (iv) placing the relationship summary among numerous other disclosure and/or promotional documents.

- **Failure to Clearly Describe Affiliate Relationships.** Form CRS requires affiliated firms that prepare a single relationship summary to "present the brokerage and investment advisory information with equal prominence, and clearly distinguish and facilitate comparison of the two types of services." The staff observed that some affiliated firm relationship summaries were difficult to understand because: (i) the firm did not clearly state which firm offers which services or investment products discussed in the relationship summary; (ii) the firm did not attribute disclosures to a particular firm or did not make it clear that they apply to both; and (iii) the firm listed numerous affiliated entities, without clearly describing the relationship between the firm and such affiliates. The staff also noted that if affiliated firms prepare separate relationship summaries, each firm must reference, or provide a means to access, the relationship summaries of their affiliates.
- **Poor Design of Relationship Summary.** The staff observed some firms that did not use the required text features for certain information (e.g., conversation starters) and did not utilize white space or other design features to improve readability.
- **Use of Marketing Language.** The staff observed relationship summaries that included "marketing language, touted firms' abilities, or used superlatives or similar descriptors." The staff indicated that relationship summaries are a "source for objective disclosure and information, rather than marketing materials." For example, the staff observed that some firms inappropriately claimed they were held to the "highest possible legal standard."
- **Boilerplate Explanations.** The staff observed the use of boilerplate explanations in the relationship summaries "that did not appear to be tailored to the particular firm's services, fees, relationships, or conflicts." For example, the staff reviewed a number of firms that used boilerplate language to suggest the firm "may" have a particular conflict, which the staff believes undermines the goal of highlighting conflicts.

Summary of Other Developments Related to Reg BI

- On November 4, 2021, in a speech at the ALI CLE Conference on Life Insurance Company Products, SEC Commissioner Allison Herren Lee remarked on what she believes are the two critical aspects of Reg BI: (i) how "recommendation" should be interpreted, and (ii) how the SEC and firms should address conflicts of interest. A copy of Commissioner Lee's full speech is available at https://www.sec.gov/news/speech/lee-complying-reg-bi-20211104?utm_medium=email&utm_source=govdelivery.
- On November 4, 2021, the North American Securities Administrators Association (NASAA) published the results of its 2021 Reg BI Phase Two Report. Broadly, the report concluded that most firms continue to operate "precisely the same under Reg BI as they had under the suitability rule" and "too many Reg BI firms are still placing their financial interests ahead of their retail customers[.]" A full copy of NASAA's report is available at https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.
- On November 2, 2021, SEC Chair Gary Gensler spoke at SIFMA's Annual Meeting. He remarked that, based on the public's response to a request for comment about potential conflicts of interest and digital engagement practices,^[4] "there could be two potential rulemakings - one with respect to investment advisers and another with

regard to broker-dealers." [5] Chair Gensler's full speech is available at <https://www.sec.gov/news/speech/gensler-sifma-110221>.

- On October 5, 2021, SEC Chair Gary Gensler testified before the U.S. House of Representatives Committee on Financial Services. Among other themes, Chair Gensler addressed predictive data analytics, noting the potential risks of some of these models and referencing the SEC's request for comment on digital engagement practices. Chair Gensler's full testimony is available at <https://www.sec.gov/news/testimony/gensler-2021-10-05>.
- On September 20, 2021, XY Planning Network (XYPN) filed a petition with the SEC for rulemaking on title restrictions and "solely incidental" sales advice. XYPN's primary requests are that: (1) the SEC "complete its 2007 proposed rule to restrict brokers from marketing themselves as financial planners, offering financial planning services, or delivering a financial plan;" and (2) the SEC "[i]ssue rules modernizing the interpretation of Section 208(c) of the Advisers Act" [which prohibits a person registered under the Advisers Act from representing that he is an investment counsel or using the title "investment counsel" unless that is his principal business or a substantial part of his business consists of providing investment supervisory services]. A full copy of XYPN's petition is available at <https://www.sec.gov/rules/petitions/2021/petn4-777.pdf>.

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endnotes

[1] Rule 15l-1 under the Securities Exchange Act of 1934.

[2] Form CRS, along with its instructions, is *available at* <https://www.sec.gov/files/formcrs.pdf>.

[3] The full text of the staff statement is *available at* <https://www.sec.gov/news/statement/staff-statement-form-crs-disclosures-121721>.

[4] For a summary of the SEC's request for comment on digital engagement practices, *please see* ICI Memorandum No. 33752 (Sept. 2, 2021), available at <https://www.ici.org/memo33752>.

[5] Although Chair Gensler referenced two potential rulemakings, the SEC's long-term Fall 2021 regulatory agenda does not provide any detail regarding the Commission's next action on this topic or an anticipated date. See <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202110&RIN=3235-AN00>.

should not be considered a substitute for, legal advice.