

Form CRS Update – OCIE Risk Alert on Initial Examinations

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Overview

On April 7, 2020, the Securities and Exchange Commission’s (the “SEC” or the “Staff”) Office of Compliance Inspections and Examinations (“OCIE”) issued a Risk Alert¹ to provide SEC-registered broker-dealers and investment advisers (collectively, “firms”) with information about the scope and content of initial examinations related to Form CRS (“Form CRS” or the “Rule”).² Firms should be aware that these initial examinations are likely to occur within the first year of the Rule’s June 30, 2020 compliance date, which the SEC has not extended in light of the COVID-19 pandemic.³ Broker-dealers should also be aware that the Financial Industry Regulatory Authority (“FINRA”) has stated it will take the same approach as the SEC when conducting its initial examinations of broker-dealers for Form CRS compliance.⁴

Guidance on Examinations

According to the Risk Alert, initial examinations will focus on whether firms have made a good-faith effort to implement Form CRS. In carrying out this assessment, OCIE will likely focus on the following areas of the Rule: (i) delivery and filing; (ii) content; (iii) formatting; (iv) updates; and (v) recordkeeping, each of which is discussed in greater detail below.

Delivery and Filing

Regarding this area of the Rule, OCIE may review for the following: (i) whether a firm has filed Form CRS (including any amendments) using Web CRD or the IARD, as applicable, and whether Form CRS is displayed on a firm’s public website; (ii) the process by which Form CRS has been delivered (e.g., electronic delivery or paper format); and (iii) whether a firm has sufficient written policies and procedures that address the required delivery process and dates. In particular, OCIE may review the dates Form CRS was provided to validate whether a firm complied with the following delivery obligations for new and existing retail investors.⁵

¹ See <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf>.

² Form CRS requires firms to deliver to retail investors a client relationship summary (“relationship summary”) that provides specific information about the firm. Firms must also file their initial relationship summary, along with any amendments, with the SEC using Web CRD (in the case of a broker-dealer) or the IARD (in the case of an investment adviser). Firms must also post a current version of their relationship summary on their public website if they have one.

³ On April 2, 2020, SEC Chairman Jay Clayton released a public statement noting the June 30, 2020 compliance date would not be extended in light of the COVID-19 pandemic (<https://www.sec.gov/news/public-statement/statement-clayton-investors-rbi-form-crs>).

⁴ See <https://www.finra.org/media-center/newsreleases/2020/finra-statement-secs-ocie-risk-alerts-reg-bi-and-form-crs>.

⁵ Exchange Act Rule 17a-3(a)(24) and Advisers Act Rule 204-2(a)(14)(i) both require a registered broker-dealer or investment adviser to record the date Form CRS was provided to each retail investor.

Existing Retail Investors. Form CRS must be delivered by July 30, 2020⁶ and before or at the time of the following:

- the opening of a new account that is different from the retail investor’s existing account (for investment advisers and broker-dealers);
- a recommendation of a rollover of assets from a retirement account into a new or existing account or investment (for investment advisers and broker-dealers); or
- a recommendation of a new brokerage or investment advisory service or investment outside of an existing account (e.g., variable annuities or a first-time purchase of a direct-sold mutual fund through a “check and application” process) (for investment advisers and broker-dealers).

New Retail Investors. Form CRS must be delivered before or at the earliest of the following:

- the entering of an investment advisory contract with a retail investor (for investment advisers);
- a recommendation to a retail investor of an account type, a securities recommendation or an investment strategy involving securities (for broker-dealers);
- the placing of an order for a retail investor (for broker-dealers); or
- the opening of a brokerage account for a retail investor (for broker-dealers).

Content

OCIE may review the content of Form CRS to assess whether (i) it includes all required information as set forth in the Form CRS Instructions;⁷ and (ii) it contains true and accurate information and does not omit any material facts. In particular, OCIE noted it may review for the following information:

- how the firm describes the relationships and services it offers, including statements on account monitoring and investment authority;
- how the firm describes its fees and costs, such as the principal fees and costs retail investors will incur and other fees and costs (e.g., custodian fees, account fees, fees related to mutual funds and variable annuities and other transactional or product-level fees); importantly, OCIE may request certain documents such as fee schedules, advisory agreements and brokerage agreements to cross-reference against a firm’s Form CRS to ensure proper disclosure of these fees and charges;
- how the firm describes the manner in which its financial professionals are compensated (e.g., cash and noncash compensation and any conflicts of interest associated with such compensation); and
- whether the firm accurately discloses any legal or disciplinary history of the firm or its financial professionals.

Formatting

OCIE may review Form CRS to assess whether it includes particular wording where required, uses text features where required and is written in plain English.

Updates

OCIE may review a firm’s written policies and procedures for updating Form CRS to assess:

(i) how and whether a firm updates and files its Form CRS within 30 days after any information becomes materially inaccurate; (ii) how and whether a firm communicates these changes to retail investors within 60 days of the updates; and (iii) the firm’s process for highlighting to retail investors the most recent changes and including an exhibit highlighting or summarizing material changes with any filed updates.

⁶ Broker-dealers and investment advisers are required to deliver Form CRS to existing customers and clients within 30 days after the date the firm must file the relationship summary with the SEC. Thirty days after the June 30, 2020 compliance date is July 30, 2020.

⁷ See <https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf>.

Recordkeeping

OCIE may assess the firm's records related to delivery of Form CRS and the policies and procedures regarding record-making and recordkeeping to assess how the firm complies with the Rule's delivery and recordkeeping obligations.

Conclusion

Importantly, OCIE's Risk Alert also urged firms to engage with the Staff if there is an inability to comply with Form CRS by June 30, 2020 due to the effects of COVID-19. Chairman Clayton previously noted his expectation that the Staff would take such difficulties into account during SEC examinations and enforcement actions.

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