

# Firms Need to Shape Up their Relationship Summaries in the New Year

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On December 17, 2021, the SEC's Standards of Conduct Implementation Committee ("Committee") published a statement that provides guidance to firms on how they can improve their Form CRS relationship summaries. Although staff statements have no legal force or effect and create no new or additional obligations, broker-dealers and Registered Investment Advisors ("RIAs") will have a better relationship with examiners if they adhere to this guidance and shape up their Form CRS in the New Year.

Form CRS is a short document that is designed to help retail investors make informed choices regarding the relationship that best suits their financial circumstances and investment goals. The goal of the relationship summary is to provide succinct, objective disclosures to retail investors, so they can compare firms and financial professionals.

Although investment advisors and broker-dealers may believe they have satisfied their Form CRS disclosure obligations, firms may not realize that their efforts have fallen short. Furthermore, when firms deviate from the required format for Form CRS, investors are not able to make an informed choice of the relationship that is the right fit for their financial circumstances and investment objectives.

The Committee is comprised of staff from the SEC's Division of Trading and Markets, the Division of Investment Management, the Division of Examinations, and the Office of Investor Education and Advocacy. To formulate its guidance, the Committee reviewed filed relationship summaries from a diverse cross-section of firms. The Committee also utilized information derived from the Division of Examinations and FINRA's exams that assessed firms' compliance with Form CRS requirements. The statement is [available here](#).

## ***Staff observations regarding Form CRS improvements***

In their statement, Committee staff members made the following observations regarding firms' relationship summaries:

**Firms used technical language, including disclaimers and hedging language.** Firms should avoid legal jargon and highly technical business terms without providing a clear explanation. The statement specifically cited terms such as "riskless principal" and "in arrears," as well as "markups" and "markdowns." Firms also cited certain SEC rules without explaining them in plain English.

**Firms omitted required information.** As a general rule, firms must include all required headings and conversation starters, as well as the prescribed language. In limited circumstances, firms may modify or omit a required disclosure or conversation starter where: (i) it does not apply to the firm's business model; or (ii) the specific wording required by the instructions would be inaccurate when applied to the firm.

**Firms relied on proposed rather than final instructions to Form CRS.** Staff members observed relationship summaries that omitted required information, modified prescribed language, or failed to follow the prescribed order or formatting requirements because firms did not rely upon the final instructions to Form CRS.

**Firms failed to include specific references to more detailed information.** Firms must provide detailed information in their relationship summary sections that describe the firm's services, fees and costs, and conflicts of interests. At a minimum, these references must include the same or equivalent information required by Form ADV, Part 2A and Regulation Best Interest to the extent they apply. A relationship summary posted on a firm's website or provided electronically in some other way must provide a means to facilitate access to any available online information referenced in it.

**Firms' descriptions of relationships and services were deficient.** Firms are not permitted to include disclosures in their relationship summaries beyond those that are required or permitted by the form's instructions. In addition, all information in a relationship summary must be true and may not omit any material facts that are necessary to ensure that the required disclosures are not misleading. Furthermore, the disclosures in the relationship summary should be responsive and relevant to the topics covered.

The Committee's staff observed shortcomings related to the following disclosures:

- **Monitoring.** Firms must explain whether they monitor retail investors' investments. If they do, they must articulate the frequency, as well as any material limitations on their monitoring efforts. They must explain whether monitoring services are included in the firm's standard services.
- **Investment Authority.** Investment advisors that accept discretionary authority must describe those services, any material limitations on that authority such as the duration, and any specific circumstances that would trigger this authority. Investment advisors that offer non-discretionary services and broker-dealers must explain in their relationship summary that the retail investor makes the ultimate decision regarding the purchase or sale of investments.
- **Limited Investment Offerings.** Firms must explain whether they make available or only offer advice regarding proprietary products or a limited menu of products or types of investments. If so, the firm must describe these limitations. Some relationship summaries did not expressly state whether the firm has any product limitations. Others acknowledged their product limitations but did not describe them.
- **Principal Fees and Costs.** Firms must summarize the principal fees and

costs that retail investors will incur for their services, including how frequently they are charged and the conflicts of interest they create. Some relationship summaries used vague fee descriptions and/or did not sufficiently address the frequency with which those fees are assessed and billed.

- **Wrap Fee Program Offerings and Fees.** Investment advisors that offer wrap fee programs must accurately describe them and their related fees. In addition, firms that charge wrap fee program fees should explain that the asset-based fees will include most transaction costs and fees paid to a broker-dealer or bank that has custody of these assets. Therefore, they are higher than a typical asset-based advisory fee. Some firms' relationship summaries did not describe the services included with the wrap fee program. The Committee also took note of relationship summaries that did not adequately describe the fees and costs associated with the wrap fee program.
- **Extraneous Disclosures Regarding Standards of Conduct.** Firms must use the prescribed language, including the term "best interest," to describe their applicable standard of conduct. This requirement is intended to promote consistency in communicating these standards to retail investors, whether a firm is a broker-dealer, investment advisor, or dual registrant. Some firms referred to themselves as "fiduciaries" or stated that they are subject to a "fiduciary duty" when describing the applicable standard of conduct instead of using the prescribed language in Item 3 of Form CRS.
- **Firm and Financial Professional Compensation Arrangements and Conflicts of Interests.** Firms must summarize how their financial professionals are compensated and disclose any potential conflicts of interest related to their compensation practices. Firms should describe these conflicts in a manner that helps retail investors to understand them better and how they might motivate a financial professional.

**Firms should not modify and/or supplement the disciplinary history disclosure.** In its relationship summary, a firm must include the heading: "Do you or your financial professionals have legal or disciplinary history?" and answer "yes" or "no." The answer, of course, depends upon whether the firm or any of its financial professionals has a triggering event. In some relationship summaries, firms omitted or modified the heading or the conversation starters and/or provided extraneous language to explain their response beyond the "yes" or "no" response.

**Firms must prominently display their relationship summary on their website.** Firms that have a publicly available website must prominently post the current version of their relationship summary on it. The relationship summary must be posted in a location and format that is easily accessible for retail investors. In some instances, staff members were unable to locate a relationship summary on the firm's website or were only able to locate it after an extensive search. The Committee's staff observed common issues that caused relationship summaries to be difficult to locate such as:

- Using small or hard-to-read text in the hyperlink to the relationship summary;

- Using a non-descriptive term or phrase to label the relationship summary, such as “regulatory disclosures”;
- Placing the hyperlink to the relationship summary several pages and clicks away from the website’s home page; and
- Inserting the relationship summary among numerous other disclosures and documents.

**Firms must accurately describe affiliate relationships.** Affiliated firms that choose to prepare a single relationship summary must present the investment advisory and brokerage information with equal prominence. They must also clearly distinguish and facilitate comparison of the two types of services.

**Firms must avoid poorly designed relationship summaries.** The Committee’s guidance urged firms to make their relationship summary easy to read and understand. To accomplish this goal, firms should use white space and other design features. They are specifically required to use text features for certain information, such as conversation starters and headers. The Committee also encouraged firms to use charts, graphs, tables, and other graphics or text features to explain or compare different aspects of their offerings.

**Firms must refrain from using marketing language.** The relationship summary is designed to provide objective disclosure and information, not marketing hype. Firms may not make exaggerated or unsubstantiated claims. Relationship summary responses must be factual and balanced, so investors can objectively evaluate the firms’ services.

**Firms must avoid using vague and imprecise boilerplate explanations.** Those kinds of explanations hinder transparency or comparisons between firms. The Committee’s staff observed disclosures in some relationship summaries that were not tailored to the firm’s services, fees, relationships, or conflicts.

## ***Conclusion***

Along with their other New Year’s resolutions, investment advisors and broker-dealers should resolve to improve their Form CRS relationship summaries in 2022. In addition to their critical observations, the Committee’s staff members cited positive examples of simple and clear disclosures. Those firms were praised for providing balanced and objective descriptions of their services, as well as direct and concise explanations of fees. They avoided extraneous language and legal jargon and used plain English in Form CRS.

RIAs should ensure that Form CRS is consistent with their Form ADV disclosures, policies and procedures, advisory agreements, websites, social media sites, and marketing materials, as well as the firm’s actual practices. Firms should also make certain that all of the hyperlinks provided are accurate and functional.

Omitting required disclosures prevents retail investors from easily comparing different firms’ relationship summaries and getting the facts they need to select financial professionals, as well as the accounts and services available to them. Furthermore, when firms include impermissible, extraneous,

or unresponsive disclosures, it becomes much harder for investors to focus on the key elements of Form CRS.