Proskauer

OCIE Issues Risk Alert in Connection with Upcoming Deadline for New Form CRS

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On April 7, 2020, the Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations (OCIE) issued a risk alert in connection with upcoming examinations that will focus on compliance with Form CRS.

By way of background, Form CRS was proposed on April 18, 2018 and subsequently adopted on June 5, 2019, in what the SEC described as an effort to enhance the quality and transparency of retail investors' relationships with registered investment advisers (each an "RIA"). Form CRS and its related rules require firms to deliver to retail investors a brief customer or client relationship summary that provides information about the firm. An exempt reporting adviser is not an RIA and, therefore, is not subject to the Form CRS requirements.

For purposes of Form CRS, the term "retail investor" is defined as "a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or household purposes." The instructions to Form CRS provide that "[i]f [an RIA does] not have any retail investors to whom [the RIA] must deliver a relationship summary, [the RIA is] not required to prepare or file one." On November 26, 2019, the staff of the SEC's Division of Investment Management issued a number of staff interpretations to frequently asked questions on Form CRS. This included the staff taking the position that pooled investment vehicles, such as hedge funds, private equity funds and venture capital funds, would not meet the definition of a retail investor, even if investors in such private funds included natural persons who themselves may be "retail investors" as defined in Form CRS.

Officially designated as Form ADV, Part 3, RIAs will be required to (i) file their Form CRS with the SEC via the web-based Investment Adviser Registration Depository (IARD), and (ii) post the current Form CRS prominently on the RIA's website (if it has one) in a location and format that is easily accessible for retail investors. Beginning on April 6, 2020, RIAs have been able to file the Form CRS with the SEC via the IARD. After the upcoming June 30, 2020 compliance date, OCIE will begin examinations to assess whether RIAs have made a good faith effort to implement Form CRS.

An RIA must make initial delivery of the relationship summary to existing retail investors by June 30, 2020. In addition, an RIA must deliver to each new retail investor its current Form CRS before or at the earliest of (i) entering into an investment advisory contract with that retail investor, (ii) a recommendation to a retail investor of an account type, a securities transaction, or an investment strategy involving securities, (iii) placing an order for the retail investor, or (iv) the opening of a brokerage account for the retail investor. An RIA must also deliver to each existing retail investor its current Form CRS whenever the RIA (a) opens a new account that is different from the retail investor's existing account(s), (b) recommends that the retail investor roll over assets from a retirement account into a new or existing account or investment, (c) 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, or (d) receives a request for a copy of the RIA's current Form CRS from a retail investor (such delivery must be made within 30 days). An RIA must also communicate, free of charge, any changes made to Form CRS to each retail investor who is an existing client within 60 days after the amendments are required to be made. This communication can be made by delivering the amended Form CRS or by communicating the information through another disclosure that is delivered to the retail investor.

In preparing Form CRS, RIAs must summarize information about the firm's relationships and services offered to retail investors, its fees and costs that retail investors will incur, the firm's conflicts of interest, and the manner in which the firm's financial professionals are compensated, and whether or not the RIA and its financial professionals have any reportable disciplinary history. The Form CRS must have a standardized question and answer format to promote comparison by retail investors in a way that is distinct from existing disclosures, and will permit the use of layered disclosure so that retail investors can more easily access additional information from the RIA about these topics. Layered disclosure includes encouraging, and in some cases requiring, hyperlinks to additional information and other textual features, such as hovers, to provide descriptions or definitions of terms.

Firms must make and preserve records of each version of their Form CRS and each amendment filed with the SEC. Firms must also make and preserve a record of the dates that each Form CRS was provided to any client, customer, or prospective client or customer who subsequently becomes a client or customer. Such records must be maintained in the same manner, and for the same period of time, as other books and records under Rule 204-2 of the Investment Advisers Act of 1940, as amended (the "Advisers Act").

The OCIE risk alert identifies the following five areas that the examinations staff intends to focus on with respect to Form CRS compliance: (i) delivery and filing; (ii) content; (iii) formatting; (iv) updates; and (v) recordkeeping.

- **Delivery and filing** – In addition to assessing compliance with the requirements discussed above, the OCIE staff intends to evaluate the process for delivering the Form CRS to existing and new retail investors, and review an RIA's policies and procedures required under Rule 206(4)-7 of the Advisers Act to assess whether they address the required Form CRS delivery processes and dates.
- **Content** – OCIE staff may review an RIA's Form CRS to assess whether it: (i) includes all required information; and (ii) contains true and accurate information and does not omit any material facts necessary in order to make the required disclosures, in light of the circumstances under which they were made, not misleading.
- **Formatting** – OCIE staff may review an RIA's Form CRS to assess whether it is formatted in accordance with the instructions to Form CRS (e.g., it includes

particular wording where required, it uses text features where required, and it is written in plain English).

- **Updates** – OCIE staff may review an RIA's policies and procedures for updating the Form CRS to: (i) assess how and whether an RIA updates and files its Form CRS within 30 days after any information contained therein becomes materially inaccurate; (ii) assess how and whether an RIA communicates these changes to retail investors within 60 days after the updates are required to be made; and (iii) assess the RIA's process for highlighting to retail investors the most recent changes, and including an exhibit highlighting or summarizing material changes with any filed updates.
- **Recordkeeping** – OCIE staff may review the RIA's records related to delivery of the Form CRS, and the policies and procedures regarding record-making and recordkeeping, to assess how the RIA complies with applicable delivery and recordkeeping obligations.

In light of the COVID-19 pandemic, OCIE has announced that it has moved to conducting examinations off-site through correspondence, unless it is absolutely necessary to be on-site. It remains to be seen whether OCIE will have resumed on-site examinations by the upcoming June 30, 2020 compliance date for Form CRS.

Firms are encouraged to assess their implementation plans and overall level of preparedness for Form CRS as the compliance date nears. Please do not hesitate to reach out to any of the authors of this alert or your regular Proskauer contact should you have any questions or otherwise require any assistance regarding the Form CRS requirements.