

## Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter Archive Message #696

Date:18-Jun-18

### Subject: Mary E. Vandenack and the SEC's Proposed Rule Requiring a Customer Relationship Summary

*"The SEC has proposed a package of rules to enhance the protection of retail customers. One of the proposed rules requires both investment advisers and broker-dealers to provide a Customer Relationship Summary (CRS) to retail investors that explains the nature of the relationship between the investor and the investment adviser or broker-dealer, services being provided, standards of conduct, conflicts of interest, and fees and costs associated with services provided.*

*The proposed rule also provides that broker-dealers cannot use the terms "adviser" or "advisor" when representing their roles to retail customers. A dually registered firm can use the terms in dealing with retail investors except that such terms can only be used by an associated natural person of a dually registered firm where such person is supervised by a registered investment adviser.*

*This commentary covers the proposed Customer Relationship Summary and use of the terms adviser or advisor. Previous commentaries covered the Proposed Best Interest Rule (delineating standards of conduct for broker-dealers and associated persons) and the SEC's companion document to the two Proposed Rules, a proposed interpretation clarifying and affirming the fiduciary duty of investment advisers."*

In [Employee Benefits & Compensation Planning Newsletter #694](#), **Mary Vandenack** provided members with her analysis of a proposed SEC interpretation clarifying and affirming the fiduciary duty of investment advisers. In [Employee Benefits & Compensation Planning Newsletter #695](#), Mary provided members with her analysis of the SEC's proposed rule "Regulation Best Interest." Now, Mary returns and shares her analysis of the SEC's proposed rule Requiring a "Customer Relationship Summary."

**Mary E. Vandenack** is founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, benefits, private wealth planning, asset protection planning, executive compensation, equity fund development, business and business succession planning, tax dispute resolution, international tax, state and local tax, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as Co-Chair of the Futures Task Force, Co-Chair of the Technology and Economics of Law Practice Committee and Vice Chair of the Asset Protection Planning Committee. Mary is a member of the American Bar Association Techshow Board and incoming Editor-in-Chief of Law Practice Magazine. Mary was named to ABA LTRC 2018 Distinguished Women of Legal Tech and recently appointed to ABA SCOTIS. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law, building sustainable law firms, and alternative fees for process-oriented law firms.

Here is her commentary:

## **EXECUTIVE SUMMARY:**

The SEC has proposed a package of rules to enhance the protection of retail customers. One of the proposed rules requires both investment advisers and broker-dealers to provide a Customer Relationship Summary (CRS) to retail investors that explains the nature of the relationship between the investor and the investment adviser or broker-dealer, services being provided, standards of conduct, conflicts of interest, and fees and costs associated with services provided. The proposed rule also provides that broker-dealers cannot use the terms "adviser" or "advisor" when representing their roles to retail customers. This commentary covers the proposed Customer Relationship Summary and use of the terms adviser or advisor. Previous commentaries covered the Proposed Best Interest Rule (delineating standards of conduct for broker-dealers and associated persons) and the SEC's companion document to the two Proposed Rules,

a proposed interpretation clarifying and affirming the fiduciary duty of investment advisers.

## **FACTS:**

The Securities and Exchange Commission (“SEC”) has proposed a rule under both the Investment Advisers Act of 1940 (“Advisers Act”) and the Securities Exchange Act of 1934 (“Exchange Act”). Such proposed rule will require registered investment advisers and registered broker-dealers to provide a customer relationship summary (“CRS”) to retail investors.<sup>i</sup> Such CRS will inform retail customers about the nature of the relationship with the broker-dealer or investment advisor, the services that will be offered, the fees and costs associated with such services, the standard of conduct of the broker-dealer or financial adviser, conflicts of interest, and whether the firm and its financial professionals currently have reportable legal or disciplinary events. The rule requires that a CRS will be provided at the beginning of the relationship between the investor and the financial adviser or broker-dealer and whenever a material change occurs. The CRS would be subject to SEC filing and record keeping requirements.

Comments are being received on the rule through August 7, 2018.

## **COMMENT:**

The CRS is limited to four pages or the equivalent if in electronic format. The CRS will be subject to a “plain language” requirement. Eight sections will be required. Those sections are as follows:

- i. Introduction
- ii. Relationships and Services the Firm Offers to Retail Investors
- iii. Standard of Conduct Applicable to those Services
- iv. Fees and Costs Retail Investors will pay
- v. Comparisons of Brokerage and Investment Advisory Services
- vi. Conflicts of Interest
- vii. Where to find additional information, including whether the firm and its financial professionals currently have reportable legal or disciplinary events and who to contact about the complaints

- viii. Key questions for retail investors to ask the firm's financial professionals.

The specific requirements for each section vary based on whether a financial professional is a financial adviser, a broker-dealer, or a dual registrant.

## **INTRODUCTION**

The introduction will be required to provide:

**Investment Adviser (IA):** "Is an Investment Advisory Account Right for You?"

**Broker-Dealer (BD):** "Is a broker Account right for You?"

**Dual Registrants (DR):** "Which Type of Account is Right for You – Brokerage, Investment Advisory or Both?"

This section will also require the firm name, registration status with the SEC, and date of the CRS.

All firms will be required to include: "There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you."

The introduction will be required to include a separate paragraph using a bolded font to reflect the following:

**IA: "We are an investment adviser and provide advisory accounts and services rather than brokerage accounts and services."**

**BD: "We are a broker-dealer and provide brokerage accounts and services rather than advisory accounts and services."**

**DR: "Depending on your needs and investment objectives, we can provide you with services in a brokerage account, investment advisory account, or both at the same time."**

## **RELATIONSHIP AND SERVICES**

**IA:** Investment Advisers will be required to provide information concerning the type of fees received by the adviser. Particularly, the CRS will be expected to include clarification as to how fees apply to investment advisory accounts as distinguished from brokerage accounts.

This section will also specify whether advice is offered on a regular basis and if so, how often. Additionally, information must be included regarding the frequency of monitoring of the investor's account.

The section will clarify the nature of investment advisory services, specify whether the account is discretionary, and whether non-discretionary accounts are offered. If there are a limited variety of investment selections, the CRS must note that other firms might offer a wider range of options.

**BD:** Broker-dealers will be required to explain the principle brokerage services as well as the nature of the transaction-based fee (commission). The CRS will be required to specify whether recommendations are offered and with whom the ultimate investment decision lies. If additional services are offered to retail investors by the broker-dealer (e.g. developing a retail investment strategy), such services must be specified along with any additional fees that will be charged for such services.

The CRS will be required to state whether performance monitoring services are offered. If such services are offered, the frequency of monitoring must be included. If the range of investment options are limited, language indicating the same must be included.

**DR:** Dual registrants will be required to note that their accounts and services fall into both categories and explain each.

## **STANDARD OF CONDUCT**

The CRS heading must be: "Our Obligations to You." The heading must be followed by: "We must abide by certain laws and regulations in our interactions with you."

**IA:** The CRS must include: “We are held to a fiduciary standard that covers our entire investment advisory relationship with you.” The CRS must also specify that the adviser is required to monitor the investor’s portfolio (unless ongoing advice is not provided).

The CRS must include language that states: “Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.”

**BD:** The CRS must note that recommendations are provided pursuant to Regulation Best Interest and include language that states: “We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities.” (Execution only brokers are not required to include this language.)

If recommendations are provided, the following language is required: “When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them.”

### **SUMMARY OF FEES AND COSTS**

All CRS’s will be required to include an explanation of the various types of fees and expenses that retail investors will pay in connection with their account. A required statement following the heading will be: “Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.”

**IA:** The CRS will be required to summarize principal fees and costs that will be incurred by retail investors. If advice is offered concerning a wrap fee program, specific language regarding the same will be required to be included. The CRS will be required to state whether fees vary by investor and whether the fees are negotiable.

**BD:** The CRS will be required to use specific language describing the transactional nature of many brokerage fees. “The fee you pay is based on

the specific transaction and not the value of your account.” The CRS must specify incentives that broker-dealers might have to place their own interests ahead of those of the investor.

**DR:** The CRS must specify if a DR will charge asset based fees or transaction-based fees and include language noting that the investor may be better off based on whether the investor will or will not trade on a regular basis. If advice is provided concerning wrap fee programs, specific language is required.

### **COMPARISONS**

**IA:** The heading will be required to state “Compare With Typical Brokerage Accounts”. This section of the CRS will be required to explain how a typical brokerage account will work as compared to the investment advisory account being offered.

**BD:** The heading will be required to state “Compare with Typical Advisory Accounts”. This section of the CRS will be required to explain how a typical investment advisory account will work as compared to the brokerage account.

A tabular chart will be required that compares transaction-based and asset-based fees side by side.

### **CONFLICTS OF INTEREST**

**IA:** Required language will be: “We benefit from the advisory services provided to you.”

**BD:** Required language will be: “We benefit from our recommendations to you.”

**DR:** Required language will be: “We benefit from the services we provide you.”

In all cases, conflicts of interest related to financial incentives and third party compensation must be included. Examples must be provided.

## **ADDITIONAL INFORMATION**

The following statement will be included in the CRS regardless of the type of firm: “We encourage you to seek additional information.” The CRS must then provide details about where such additional information can be obtained.

This section of the CRS must also provide information concerning any legal or disciplinary events involving the firm and the SEC, state securities regulators, self-regulatory organizations, or other jurisdictions.

## **KEY QUESTIONS**

The proposed rule requires a number of Key Questions be included to facilitate the retail investor in understanding the questions such investor should ask. The required questions are:

- “Given my financial situation, why should I choose an advisory account? Why should I choose a brokerage account?”
- Do the math for me. How much would I pay per year for an advisory account? How much for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?
- What additional costs should I expect in connection with my account?
- Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
- What are the most common conflicts of interest in your advisory and brokerage accounts? Explain how you will address those conflicts when providing services to my account.
- How will you choose investments to recommend for my account?
- How often will you monitor my account’s performance and offer investment advice?
- Do you or your firm have a disciplinary history? For what type of conduct?
- What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.



- Who is the primary contact person for my account, and is he or she a representative of an investment adviser or a broker-dealer? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?”

### **RESTRICTION ON THE USE OF THE TERMS ADVISER AND ADVISOR**

The proposed rule will limit the use of the terms “adviser” and “advisor” to registered investment advisers when dealing with retail investors. A dually registered firm can use the terms in dealing with retail investors except that such terms can only be used by an associated natural person of a dually registered firm where such person is supervised by a registered investment adviser.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!**

*Mary Vandenack*

### **CITE AS:**

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### **CITATIONS:**

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<sup>i</sup> 17 CFR Parts 240, 249, 275 and 279.