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# **SEC STANDARDS OF CONDUCT**

## **NAVIGATING NEW REQUIREMENTS FOR RETAIL ADVICE DISCLOSURES**

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# Agenda

1. Overview of retail advice disclosure requirements
2. What's changed for broker-dealers and investment advisers
  - Full and fair disclosure and informed consent
  - Layered disclosures
  - Focus on style and format
3. Practical pointers for Form CRS
4. Steps to draft disclosures for new rules
5. Delivery and other operational considerations
6. Hypothetical scenarios

# Overview: New Retail Advice Disclosure Requirements

- Form CRS
- Regulation Best Interest Disclosure Obligation
- Advisers Act Interpretation
- CFP Board Standards
- SROs (FINRA, MSRB)?
- Department of Labor?
- States?

# Overview: Retail Advice Disclosure Requirements

Requirement	Form CRS [New]	Reg BI [New]	Advisers Act	CFP Board [New] for CFP Pros (Not firm)
<b>Line of Business</b>	Brokerage and advisory	Brokerage	Advisory	Advice and financial planning services from CFP professionals
<b>Customer/Client</b>	Retail investors	Retail customers	Clients	Clients (including businesses) receiving services from a CFP professional
<b>Timing</b>	Earliest of: <ul style="list-style-type: none"> <li>• Advisory contract</li> <li>• Brokerage recommendation</li> <li>• Placing an order</li> <li>• Opening a brokerage account</li> </ul>	Prior to or at the time of the recommendation	Generally, prior to or at the time of entering into an advisory contract	Prior to or at the time of engagement (an oral or written agreement, arrangement, or understanding)

# Overview: New Retail Advice Disclosure Requirements

Requirement	Form CRS [Still New]	Reg BI [Still New]	Advisers Act	CFP Board [New] for CFP Pros (Not firm)
<b>Content</b>	<ul style="list-style-type: none"> <li>• Introduction</li> <li>• Relationships and services</li> <li>• Fees, costs, conflicts, and applicable standard(s) of conduct</li> <li>• Disciplinary history</li> <li>• Additional information</li> </ul>	<p>Material facts relating to scope and terms of relationship:</p> <ul style="list-style-type: none"> <li>• Capacity</li> <li>• Fees and costs</li> <li>• Type and scope of services, including material limitations</li> <li>• Conflicts</li> </ul>	<p>Material facts relating to advisory relationship:</p> <ul style="list-style-type: none"> <li>• Capacity</li> <li>• Fees and costs</li> <li>• Type and scope of services, including material limitations</li> <li>• <b>Material</b> conflicts</li> <li>• Information required to be disclosed for Form ADV, Part 2A</li> </ul>	<ul style="list-style-type: none"> <li>• Services and products</li> <li>• Fees and costs</li> <li>• Compensation</li> <li>• Discipline</li> <li>• Bankruptcies</li> <li>• Referral arrangements</li> <li>• Conflicts</li> <li>• Written privacy policies</li> <li>• Terms of engagement</li> <li>• Financial planning implementation responsibilities</li> <li>• Financial planning monitoring and updating responsibilities</li> </ul>

# What Has Changed for Broker-Dealers?

- **Rationale:**

**Reg BI:** “To promote broker-dealer recommendations that are in the best interest of retail customers, [the SEC] determined it was necessary to impose a more explicit and broader disclosure obligation on broker-dealers than that which currently exists under the federal securities laws and SRO rules.”

**Form CRS:** “ ... to reduce retail investor confusion in the marketplace for brokerage and investment advisory services and to assist retail investors with the process of deciding whether to engage, or to continue to engage, a particular firm or financial professional and whether to establish, or to continue to maintain, an investment advisory or brokerage relationship.”

- **New rules:**

- Form CRS relationship summary
- Disclosures regarding:
  - Capacity
  - Fees and costs
  - Type and scope of services provided
  - Material facts regarding conflicts of interest
- Upfront (but layered)

# What Has Changed for Investment Advisers?

- Form CRS relationship summary
- Investment Adviser Interpretation
  - Focus on “full and fair disclosure” of
    - All material facts relating to the advisory relationship (capacity)
    - Conflicts that might incline an adviser to render advice that is not disinterested
    - Increased emphasis on clarity around scope of services and limitations (including monitoring)
    - “May-based” disclosure
  - Informed consent
    - Not a client-specific determination
    - Disclosure should be designed to put a client in a position to be able to understand and provide informed consent to the conflict
    - Explicit or implicit, but not where adviser is aware that client does not understand
  - Disclosure obligations for account-type and rollover recommendations

# Full and Fair Disclosure and Informed Consent (Advisers Act Interpretation)

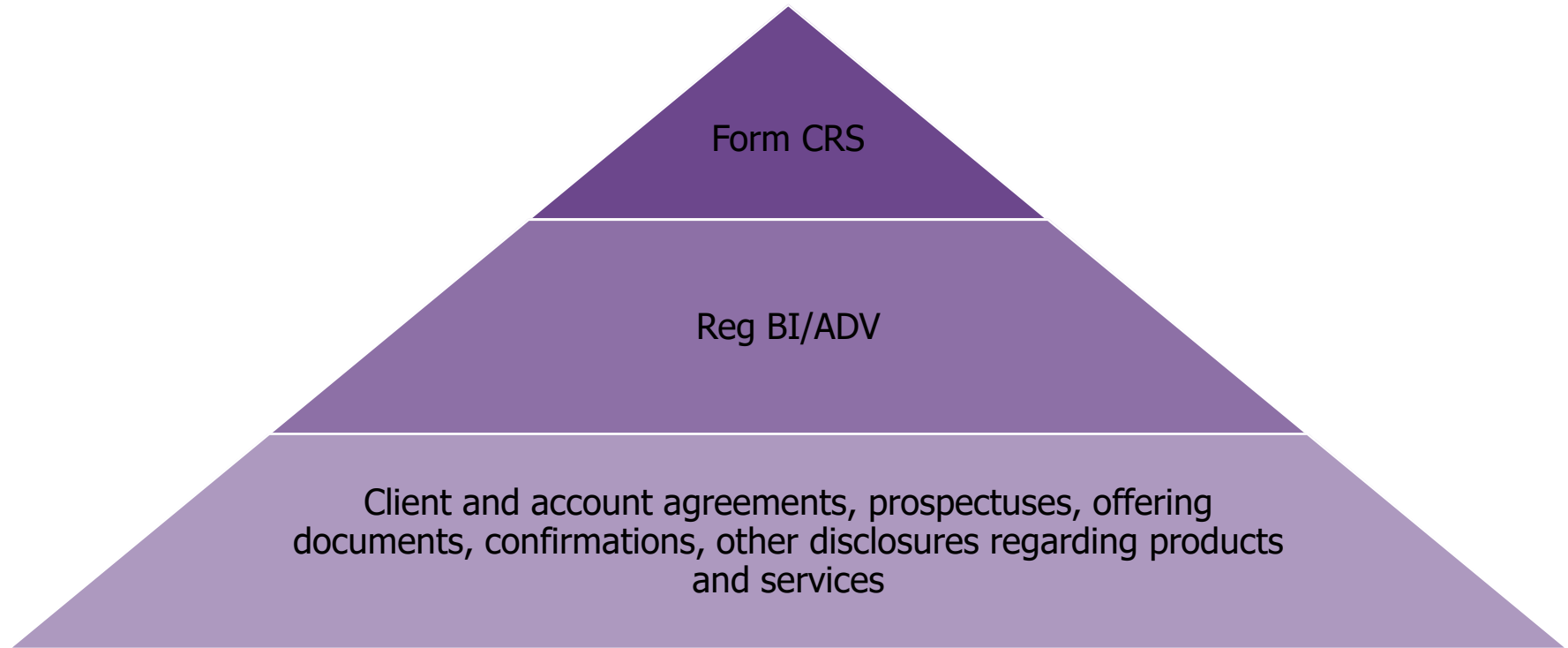
- Whether a disclosure is full and fair depends on facts and circumstances:
  - Nature of client
  - Scope of services
  - Material fact or conflict
- “Full and fair disclosure for an institutional client can differ ... significantly from full and fair disclosure for a retail client”
  - Specificity
  - Level of detail
  - Explanation of terminology
- “For retail clients ... it may be difficult to provide disclosure regarding complex or extensive conflicts that is sufficiently specific, but also understandable.”
  - If adviser cannot fully and fairly disclose a conflict, eliminate or adequately mitigate



# Full and Fair Disclosure and Informed Consent: Spell it Out

- Try to draft disclosure so that the reader does not have to infer the firm's conflict or guess what he or she is agreeing to.
  - *Compare this*: "We receive compensation from certain fund sponsors when we recommend their funds. This practice presents us with a conflict of interest."
  - *With this*: "Some fund sponsors pay us to recommend their funds to you. We have a conflict of interest because we have an incentive to recommend funds whose sponsors pay us more over funds whose sponsors pay us less or do not pay us at all."

# Layered Disclosures



# Layered Disclosures: Considerations

- Summary vs. detailed
- Maintaining consistency
- Linking and cross-referencing
- Legalese vs. plain English
- Delivery timing

# Focus on Style and Format

- Accessibility
- Readability
- Clarity
- “Plain English”—old rule, new focus?
- White space
- Font size
- Margins
- Page length
- Graphics, pop-ups, mouseovers

# Form CRS Drafting Tips

- Plain English is your friend
  - Write short, clear sentences
    - Keeps the word count down
    - Leaves more space for graphics
    - The SEC expects you to use plain English
  - Use shorter words:
    - pay, not compensate
    - sell, not liquidate
    - of, about, or for, not with respect to
  - Avoid passive voice

# Form CRS Drafting Tips

- Cut back on investment terminology and legalese
  - Adopting release cautions against use of highly technical terms without definition
  - Definitions eat up space in Form CRS, so use defined terms sparingly
- Consider appropriate level of detail
- Sources for writing tips:
  - The SEC's handbook, <https://www.sec.gov/pdf/handbook.pdf>
  - Wydick & Sloan, *Plain English for Lawyers*

# Form CRS Drafting Tips

- Make it interesting
  - The SEC encourages firms to use graphics and text features
  - Firms required to use text features for the “conversation starters”
  - Consider using colors, symbols, or different fonts to break up the document
  - Consider other disclosures for ideas on graphic designs and layouts (e.g., marketing materials and mutual fund prospectuses)
- Keep these drafting tips in mind when preparing Reg BI disclosures and reviewing Form ADV

# Steps to Draft Disclosures for New Rules

1. Inventory and map current client-facing disclosures, including for:
  - Prospecting
  - Account opening/onboarding
  - Relationship maintenance/ongoing
2. Identify services to retail investors
3. Draft Form CRS first to help outline business/compliance strategy
4. Consider whether historic disclosures need to be revised
  - Clarity and understandability for retail investors
  - Limiting and clarifying scope of services, including for changes made in connection with new rules
5. Draft Reg. BI disclosures considering Form CRS and historic disclosures that can be leveraged



# Steps to Draft Disclosures for New Rules

6. Determine whether and how to support CFP Professionals
7. Keep in mind business impacts of disclosure requirements
  - Capacity
  - Approach to monitoring
  - Pressure on open architecture
  - Complex conflicts and facts of relationships
  - Client/customer expectations
  - FA needs

# Delivery and Operational Considerations

- Delivery rules of the road
  - Prospecting – to deliver or not to deliver?
  - Education vs. recommendation
  - Implicit hold recommendations
  - Stop-gap-include disclosures in account opening/onboarding materials
  - Redelivery during course of client relationship
  - Document approach

# Delivery and Operational Considerations

- Formats
  - Hard-copy, electronic, or both
  - When to consider using graphics
- Ongoing maintenance
  - Disclosure inventories and reviews
  - New products, programs, and platforms
  - Changes and disclosure errors
  - Refiling Form CRS with the SEC
- Recordkeeping delivery

# Hypothetical: IRA Rollover

- Joe recently left his job, where he had been participating in a 401(k) plan, and visits Jane a financial professional at Acme Corp. They begin discussing Jane's work at Acme, and the conversation trends toward a discussion of how Jane might help Joe decide what to do with his 401(k) account.
- Questions:
  - What disclosures need to be provided and when?
  - What is Jane's default "capacity"?
  - How might Jane avoid triggering a disclosure obligation?
  - What if the discussion was by phone instead?
  - Other regulatory obligations to consider (e.g., DOL)?

# Hypothetical: Additional Account Recommendation

- After they meet, Jane (and Acme) began servicing Joe's IRA rollover account. Six months later, Jane learns that Joe is unhappy with the other financial professional with whom he works. Jane recommends that Joe transfer his other non-retirement brokerage account to Acme and open a new brokerage account with Acme.
- Questions:
  - What disclosures need to be provided and when?
  - What is Jane's default "capacity"?
  - How does the method of discussion (e.g., phone, email, in person) impact the disclosure approach?
  - Other regulatory obligations to consider (e.g., DOL)?

# Next Steps

- Assemble your disclosure team
- Inventory and map current disclosures
- Consider developing disclosure guidelines/stylebook
- Review for the word “may”
- Draft Form CRS
- Plan for tech builds and lead times
- Consider how we can help and partner with you 😊

# Questions and More to Come

- Questions
- More to come
  - You can find more analysis, templates, materials, and information about our events at <https://www.morganlewis.com/retailadvice>

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Brian J. Baltz focuses his practice on the regulation of investment advisers, broker-dealers, and bank fiduciaries. Brian counsels clients offering investment advice and brokerage services through their private wealth and private client businesses on issues arising under regulation by the Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA), and Office of the Comptroller of the Currency (OCC). Brian advises investment advisers, broker-dealers, and banks on investment management issues, including conflicts, disclosure, trading, wrap fee programs, soft dollar arrangements, advertising, and other ongoing regulatory compliance matters.

Before joining Morgan Lewis, Brian held multiple positions in the SEC's Division of Trading and Markets, including in the Office of Chief Counsel and Office of Market Supervision. While in the Office of Chief Counsel, he was part of the team responsible for drafting a proposed rule to establish a uniform standard of conduct for broker-dealers and investment advisers. Prior to his work at the SEC, Brian was public policy counsel to a financial services industry trade association based in Washington, DC, where he worked on legislative and regulatory issues impacting broker-dealers and investment advisers, including the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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Lindsay B. Jackson counsels broker-dealers, investment advisers, banks and other financial services firms on the rules that apply when they provide advice and services to retail investors, including, in particular, those investing through IRAs and employee benefit plans.

Lindsay helped clients respond to the now vacated Department of Labor fiduciary rule, including developing business strategies and disclosures, as well as engaging with the regulator to seek clarifying guidance. Lindsay continues this work in connection with the SEC's Regulation Best Interest and related rules and interpretations, and developing fiduciary standards in the states.

# Jennifer L. Klass



Jennifer L. Klass is a regulatory counseling lawyer with a broad background in investment management regulation. She advises clients on a wide range of investment advisory matters, including investment adviser registration and interpretive guidance, disclosure and internal controls, regulatory examinations, and enforcement actions. Her clients include major investment banks, investment advisers, broker-dealers, and the sponsors of private investment funds and mutual funds. Previously vice president and associate general counsel at Goldman, Sachs & Co., Jen's practice focuses on the convergence of investment advisory and brokerage services.

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Advertising and communications with the public, social media, and fiduciary duty and disclosure are among the securities regulatory areas in which Jen counsels clients. She also advises them on investment adviser registration, internal controls, compliance policies and procedures, separately managed (or wrap fee) programs, regulatory examinations and enforcement actions, interpretive guidance, and no-action requests.

While at Goldman, Sachs, Jen counseled its private wealth management and asset management businesses. She was also previously an associate at Morgan Lewis.

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Daniel R. Kleinman advises businesses on the fiduciary responsibilities provisions (Title I) of the Employee Retirement Income Security Act (ERISA). He also counsels these clients on related tax, corporate, and securities laws in connection with the structuring and marketing of investment products (including private equity and hedge funds) and financial services to employee benefits plans. Additionally, Daniel handles issues related to the regulation of broker-dealers and investment advisers under US federal and state securities laws.

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Christine M. Lombardo advises investment managers and broker-dealers on financial regulatory matters. She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals. Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products. She is admitted in New York only, and her practice is supervised by PA Bar members.

Christine also counsels financial firms through examinations by industry regulators, as well as on enforcement related matters. Before joining Morgan Lewis, she was an associate at an international law firm in New York and worked for the Division of Enforcement at FINRA.

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Monica L. Parry's practice focuses on investment advisers and closed-end investment companies. Her background includes drafting and reviewing contracts and disclosure documents for wrap fee programs, drafting service contracts and registration statements, conducting mock exams, and counseling registered and unregistered advisers and funds on compliance issues.

Prior to entering private practice, Monica was a senior counsel in the Office of Chief Counsel, Division of Investment Management, US Securities and Exchange Commission. She joined that office as a staff attorney before becoming a senior counsel. Monica also served as counsel to Commissioner Richard Y. Roberts. Monica has co-authored numerous articles.

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Natalie R. Wengroff advises financial institutions on compliance with US state and federal regulation, including fiduciary responsibilities and ERISA matters. She also advises broker-dealers and investment advisors regarding their obligations under federal securities laws and self-regulatory organization rules such as Financial Industry Regulatory Authority (FINRA). Prior to joining Morgan Lewis, Natalie represented independent broker-dealers and financial advisors before state securities and banking commissioners.

# Kyle Whitehead



Kyle D. Whitehead is a securities lawyer who advises broker-dealers, investment advisers, and investment companies on regulatory compliance and transactional matters arising under federal and state securities laws and related US Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA), and other self-regulatory organization (SRO) rules and regulations. Prior to joining Morgan Lewis, Kyle was an associate in a nationally recognized financial services regulatory practice, where he concentrated on federal and state securities law and state insurance law issues relating to the development and distribution of variable insurance products and mutual funds.

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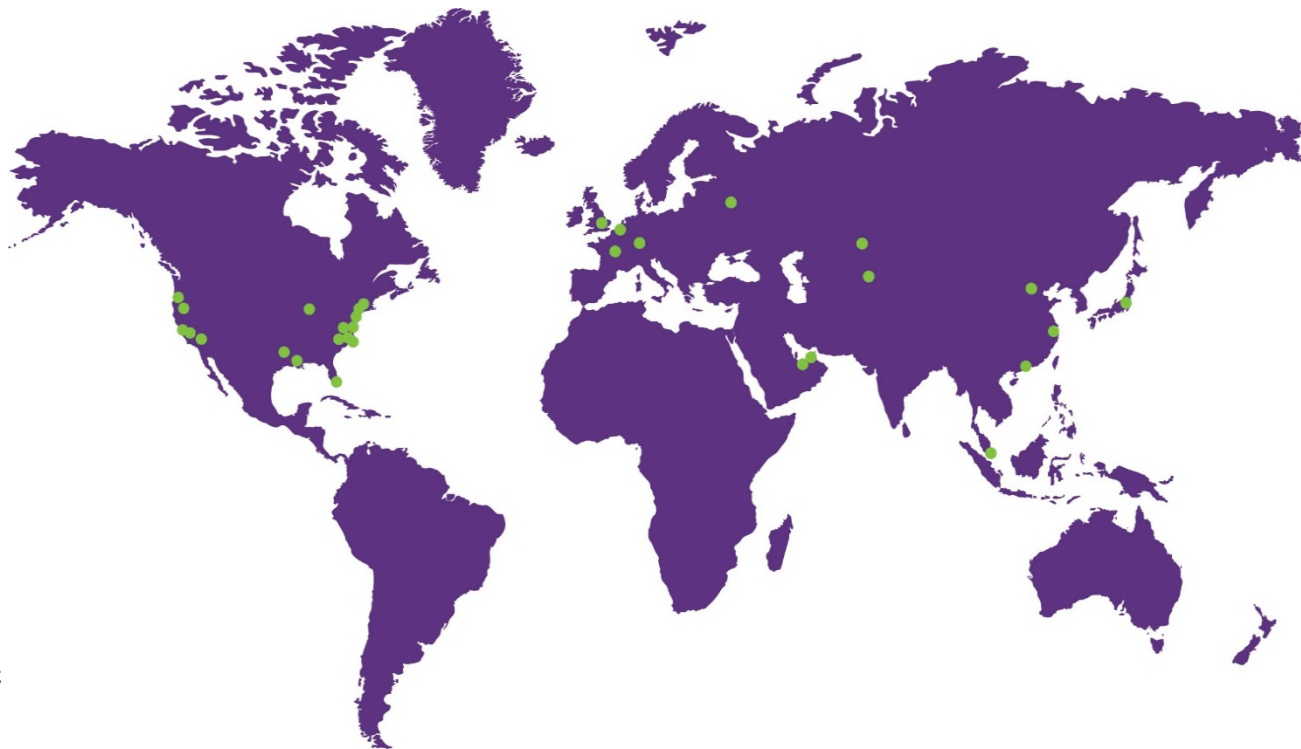


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