

Alert

SEC Form CRS: OCIE Announces Examination Focus

April 10, 2020

On April 7, 2020, the U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations announced in a Risk Alert¹ that, after the June 30, 2020 compliance date for the recently adopted Form CRS, "OCIE will begin examinations to assess compliance with Form CRS."

Private fund managers will only have to file and deliver Form CRS if, in addition to private investment fund clients, they also have clients who are natural persons with separately managed accounts. (Individuals who invest in pooled investment vehicles but have no direct advisory relationship with the manager are not clients and therefore, not covered by Form CRS.) The SEC Staff has, in published guidance, specifically indicated that advisers to pooled investment vehicles are not required to file and deliver Form CRS:

Q: My firm is an investment adviser to pooled investment vehicles, such as a hedge funds, private equity funds and venture capital funds. The investors in these funds include natural persons who may be "retail investors" as defined in Form CRS. Am I required to deliver a relationship summary to these funds?

A: An investment adviser must initially deliver a relationship summary to each retail investor before or at the time the adviser enters into an investment advisory contract with the retail investor. "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." In the staff's view, the types of pooled investment vehicles described above would not meet this definition and a relationship summary would not be required to be delivered. (Posted Nov. 26, 2019)²

In contrast, advisers with managed accounts should assess whether and how Form CRS applies to their businesses as soon as possible.

Background. Form CRS, or Part 3 of Form ADV, is a "relationship summary" that was part of a [package of updates and guidance](#) published by the SEC in June 2019. Initial Form CRS filings are required by June 30, 2020, and must be delivered to (i) existing retail investors by July 30, 2020; and (ii) new retail investors before or at the time of entering into an advisory agreement. Unlike other filings for which the SEC has

¹ Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Risk Alert: Examinations that Focus on Compliance with Form CRS (April 7, 2020).

² Securities and Exchange Commission, Division of Investment Management: Frequently Asked Questions on Form CRS (April 7, 2020).

provided relief, the SEC has not extended the compliance date for Form CRS, nor does it intend to, as reflected in public statements made by the SEC Chairman.³

For Form CRS purposes, a “retail investor” is defined as a natural person (or the legal representative of a natural person) who “seeks or receives services primarily for personal, family or household purposes.”⁴ Put differently, wealthy and sophisticated natural persons with separately managed accounts are “retail investors” for Form CRS purposes. Accordingly:

- *Advisers that only manage private funds will not be required to complete Form CRS;*⁵ and
- *Advisers with separately managed account clients should carefully examine the scope of coverage of the new form to determine if they have “natural person” clients.*

Advisers that find they are covered by Form CRS should also keep in mind that their “retail investor” clients are likely to be sophisticated in financial matters and may find some of the required disclosures in the form to be more simplified than they would otherwise expect (which may generate questions to the adviser). Covered advisers may want to proactively explain what Form CRS requires them to do and why the disclosures in the form are presented in such a basic manner.

OCIE Examination Focus. In its recent Risk Alert, OCIE announced that examinations commenced after June 30, 2020 may include an assessment of Form CRS compliance. OCIE identified several areas of likely focus, including (i) delivery and filing; (ii) content and formatting; and (iii) policies, processes and recordkeeping.

Delivery and Filing. Examiners may seek to confirm that advisers have timely filed and delivered Form CRS (and posted it on any public website). Advisers will have to demonstrate compliance with the initial filing and delivery dates described above. However, Form CRS delivery requirements can also be triggered by actions taken with existing retail clients, such as an existing retail investor opening a new account or any recommendation of a new service or investment that does not necessarily involve the opening of a new account. Tracking Form CRS delivery in these instances may be an involved undertaking.

Content and Formatting. The examination staff is expected to review the disclosure in the Form CRS for accuracy and completeness, focusing on descriptions of an adviser’s services; how accounts are monitored; how fees and expenses are described; how advisory personnel are compensated; conflicts of interest; and legal and disciplinary history. Examiners may seek to confirm that the Form CRS is written in “plain English” and incorporates the exact wording required by the instructions.

³ Securities and Exchange Commission, Chairman Jay Clayton Statement: Investors Remain Front of Mind at the SEC: Approach to Allocation of Resources, Oversight and Rulemaking; Implementation of Regulation Best Interest and Form CRS (April 2, 2020). The statement of the Chairman seems to suggest that registrants facing particular delays related to the pandemic should seek relief on an individual basis.

⁴ 17 CFR 275.204-5(d)(2)

⁵ The SEC staff has confirmed this in recent guidance: “pooled investment vehicles ... would not meet [the retail investor] definition and a relationship summary would not be required to be delivered[.]” Securities and Exchange Commission, Division of Investment Management: Frequently Asked Questions on Form CRS (April 7, 2020).

Policies, Processes and Recordkeeping. Examiners may review an adviser's policies and procedures to assess, among other things, whether they include processes for timely filing and delivery of Form CRS; timely updating and delivery of Form CRS when information therein becomes materially inaccurate; and how material changes in the form are highlighted to retail investors. Further, examiners may also review an adviser's recordkeeping obligations with respect to Form CRS, confirming that advisers are maintaining records related to when Form CRS is delivered to clients and prospective clients (who later become clients).

The OCIE announcement is a reminder of the SEC's ongoing focus on the standard of conduct required of investment advisers and broker dealers, and its use of the examination staff to confirm that advisers are fulfilling their duties to clients. Advisers that will be covered by Form CRS delivery requirements need to prepare, now, for the June 30, 2020 deadline, notwithstanding the other demands on their resources imposed by the ongoing coronavirus.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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