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The main purpose of Regulation Best Interest is to require affected broker-dealers to provide the least conflicted advice and least conflicted price to retail investors. Form CRS requires affected broker-dealers and registered investment advisers to provide a brief relationship summary to retail investors.

REGULATORY NOTICE: 19-07

THE 8 QUESTIONS YOU NEED ASK YOURSELF ABOUT REGULATION BEST INTEREST AND FORM CRS

The SEC recently adopted new rules that impose additional obligations on registered investment advisers and broker-dealers who serve retail investors. Exchange Act Rule 17l-1 is referred to as “Regulation Best Interest” and promulgates additional requirements on certain broker-dealers. Exchange Act Rule 17a-14 requires certain registered investment advisers and broker-dealers to file a Form CRS with the SEC. The Regulation Best Interest adopting release is 770 pages in length and the Form CRS adopting release is 564 pages. The following summary is intended to provide a high-level synopsis in Q&A format of the items from both rules that may be most pertinent to our clients. It is not intended to cover all requirements these new rules impose on registrants.

1. Does Regulation Best Interest and Form CRS apply to me?

- ❖ The lynchpin to Regulation Best Interest and Form CRS is “retail investor”. If you do not have any retail investors, then these new provisions will have little, if any, impact on your activities.

2. What's a "retail investor"?

- ❖ 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.

3. I have retail investors, what changes do I need to make under Regulation Best Interest?

❖ Registered Investment Advisers

- Registered Investment advisers already have a fiduciary duty to act in their client's best interest. Therefore, the Regulation Best Interest does not impose any heightened duty on investment advisers.

❖ Broker-Dealers

- When broker-dealers provide a recommendation to a retail investor, it will have to comport with a "General Obligation" to act in the retail investor's best interest and not put the broker-dealer's interest ahead of the retail investor. To fulfill the new General Obligation, broker-dealers will have to fulfill the following:
 - ✓ Disclosure Obligation – prior to or at the time of the recommendation, provide the retail investor a written full and fair disclosure of all material facts relating to the scope and terms of the relationship between the broker-dealer and the retail investor (including material fees and costs) and conflicts of interest associated with the recommendation.
 - ✓ Care Obligation – exercise reasonable diligence, care and skill to: (1) understand the potential risks, rewards and costs associated with the recommendation; (2) have a reasonable basis to believe that an individual recommendation is in the retail investor's best interest; and (3) have a reasonable basis to believe that a series of transactions taken as a whole is in the retail investor's best interest even if the individual transactions in isolation would appear to be in the retail investor's best interest.
 - ✓ Conflict of Interest Obligation – identify, disclose or eliminate all conflicts of interest associated with recommendations, including conflicts of interest that create: (1) an incentive for an associated person to place his/her or the broker-dealer's interest ahead of the retail investor's interest; and (2) material limitations associated with recommendations.
 - ✓ Compliance Obligation – establish, maintain and enforce written policies and procedures reasonably designed to comply with Regulation Best Interest.

- ❖ The SEC specifically noted in the adopting release that "Regulation Best Interest establishes a standard of conduct under the Exchange Act that cannot be satisfied through disclosure alone." Affected broker-dealers will be required to take action to meet these new obligations.

4. What actions should I take?

- ❖ Broker-dealers must eliminate sales contests, quotas, bonuses and other compensation tied to sales of specific securities within a defined time period.
- ❖ Document why recommendations to retail investors are in their best interest.

- Includes, among other things: recommending rolling over assets from a qualified plan to an individual retirement account; switching annuities; selecting share classes in mutual funds; placing a retail investor in an advisory account instead of a brokerage account and vice versa; recommending a series of transactions (i.e., not avoiding break points).
- ❖ Consider leveling compensation among asset classes recommended to retail investors.
- ❖ Consider eliminating markups on services provided to retail investors.
- ❖ Consider limiting types of customers who have access to certain products.

5. What is the deadline for making these changes?

- ❖ The rules go into effect on September 10, 2019. The date that registrants must be in compliance is **June 30, 2020**.

6. When do I have to file Form CRS?

❖ Registered Investment Advisers

- Advisers with retail investors must file their initial Form CRS (aka Form ADV, Part 3) via IARD beginning May 1, 2020 and by no later than **June 30, 2020**.
- ✓ Advisers are also required to deliver Form CRS to retail investors before or at the time they enter into an investment advisory contract (even if oral) with the retail investor.
- ✓ After the initial filing, advisers are required to deliver Form CRS to: (1) existing retail investors within 30 days after the date they first file; (2) new and prospective retail investors consistent with other ADV delivery requirements; and (3) post the current version of Form CRS on their website, if applicable, where retail investors can easily find and access it.

❖ Broker-Dealers

- Broker-Dealers with retail investors must file Form CRS via CRD beginning May 1, 2020 and by no later than **June 30, 2020**.
- ✓ Broker-Dealers are also required to deliver Form CRS to customers before or at the earliest of: (1) a recommendation of an account type, a securities transaction, or an investment strategy involving securities; (2) placing an order for the retail investor; or (3) the opening of a brokerage account for the retail investor.
- ✓ After the initial filing, broker-dealers are required to deliver Form CRS to: (1) existing retail investors within 30 days after the date they first file; (2) new and prospective retail investors consistent with other CRD delivery requirements; and (3) post the current version of Form CRS on their website, if applicable, where retail investors can easily find and access it.

❖ Dual Registrants

- You must file Form CRS via **both** IARD and CRD consistent with the timing requirements described above.

7. I have to file a Form CRS, what do I have to disclose in the form?

- ❖ Identifying information
- ❖ Description of investment services and advice, which must address monitoring, investment authority, limited investment offerings, account minimums and other requirements
- ❖ Conversation starters (as identified in the Form CRS instructions)
- ❖ Fees, costs, and conflicts
- ❖ Standard of conduct
- ❖ Disciplinary history
- ❖ How retail investors can obtain additional information
- ❖ All information must be true and not omit any material facts that would render the disclosures made misleading
 - ✓ Responses must provide balanced descriptions to help retail investors evaluate services

8. What if I have other questions?

- ❖ Contact Constellation Advisers for further guidance and assistance.
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