

Best Interest Standard of Care for Advisors #20

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Regulation Best Interest: Rollover Recommendations and Form CRS/ADV Part 3 Disclosures (Rollovers Part 6)

The SEC has issued its final Regulation Best Interest (Reg BI), Form CRS Rule, RIA Interpretation and Solely Incidental Interpretation. I am discussing the SEC's guidance in a series of articles entitled "Best Interest Standard of Care for Advisors."

This is the 6th of my series of articles about rollover recommendations and rollover education under the [SEC's Regulation Best Interest](#) and its Interpretation for Investment Advisers. (For the first five, see Best Interest for Advisors #'s [15](#), [16](#), [17](#), [18](#), and [19](#).)

This article continues the discussion of the disclosure requirements related to rollover recommendations by broker-dealers and investment advisers, but moves from the discussion in Best Interest for Advisors #19 about the disclosure requirements in Reg BI and the RIA Interpretation to the requirements in the new Form CRS Rule (which must be satisfied beginning June 30, 2020).

The Form CRS/ADV Part 3 is generally referred to as a "relationship summary" and I will use that term to refer to both the Form for broker-dealers and the one for investment advisers (since the requirements are virtually identical). The requirement to deliver a relationship summary applies to both broker-dealers and investment advisers when they make recommendations to "retail investors." As a general rule, it applies to recommendations of securities and investment strategies involving securities. But the SEC has defined an account-type recommendation to also fall under the new best interest standards for both broker-dealers and investment advisers . . . and a rollover recommendation is an account-type recommendation. Generally speaking, the relationship summary must be delivered at or before the time a rollover recommendation is made.

But that puts the cart before the horse, let's look at the basics.

First, a 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 SEC says that saving and investing for retirement is a "personal, family or household purpose". And, of course, a participant in a plan is "a natural person" and therefore is covered by the CRS requirements (and, for that matter, by the Reg BI "best interest" standard) for rollover recommendations. For example, a recommendation to a participant to roll over a retirement benefit to

an IRA would be a covered recommendation and, therefore, the relationship summary would need to be provided to the participant before or at the time of the recommendation. Similarly, recommendations about investing in a participant's 401(k) account would be covered by the Form CRS/ADV Part 3 Rule.

The relationship summary for a broker-dealer or an investment adviser can only be two pages long, and can only include information required or permitted by the Rule. However, a dual-registrant can combine the two and have a four-page disclosure document. (As an aside, the regulation mandating the two- to four-page relationship summaries and the contents is 178 pages of fine print in the Federal Register.)

The relationship summaries will be prepared by the advisors' firms, but will probably be delivered to the retail investors by advisors. The summary must contain the following 5 parts (called "items" in the instructions):

Item 1. Introduction

Item 2. Relationships and Services

Item 3. Fees, Costs, Conflicts, and Standard of Conduct

Item 4. Disciplinary History

Item 5. Additional Information

The disclosures are too detailed and too many to cover in this article, but I will post several articles on the subject in the future. For now, though, I want to point out that the relationship summaries are required to have "conversation starters" that are designed for prospective retail investors to use as questions for advisors. Here are a couple of examples that apply in the rollover context:

"How might your conflicts of interest affect me, and how will you address them?" [It's important to have a thoughtful answer to this question since a rollover recommendation is a conflict of interest.]

"Help me understand how these fees and costs might affect my investments. If I give you \$10,000 to invest, how much will go to fees and costs, and how much will be invested for me?"

In addition to delivering a relationship summary to new retail investors, broker-dealers and investment advisers must also, in three specified situations (including rollover recommendations), deliver a summary to existing customers. This is from the instructions for the relationship summary:

*"You must deliver the most recent relationship summary to a retail investor who is an existing client or customer before or at the time you: (i) open a new account that is different from the retail investor's existing account(s); **(ii) recommend that the retail investor roll over assets from a retirement account into a new or existing account or investment;** or (iii) recommend or provide a new brokerage or 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, for example, the first-time purchase of a direct-sold mutual fund or insurance product that is a security through a “check and application” process, i.e., not held directly within an account.”

While June 30 may seem like distant date, it will be upon us before we know. From the firm’s perspective (*i.e.*, the broker-dealer or RIA), the Forms must be developed, training must be developed and delivered, policies and procedures need to be written, supervisory systems need to be designed and put in place, and on and on. Now is the time to be working on this project regardless of whether your firm is an investment advisor, a broker-dealer or a dual registrant.

My next article will discuss the need to mitigate advisor compensation when rollover recommendations are made.

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