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Whitepaper



# Electronic Disclosure: SEC Requirements and the Form CRS Business Case

While there is great momentum behind the electronic delivery movement, there is no indication around when and if the regulations will change. Before your firm decides to shift from a paper-based delivery method to a digital experience, it is important to understand the SEC's delivery requirements.

In this paper, we first outline the SEC's principal requirements that brokers and advisers must meet when communicating electronically with clients. Then, using Form CRS as a case study, we highlight the advantages of implementing electronic delivery in compliance with those requirements.

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If you are reading this, chances are you accessed it online. According to the Pew Research Center, roughly 90% of American adults used the internet in 2019, up from about 50% in 2000.<sup>1</sup> This represents a fundamental shift in how we obtain and expect to receive information and communications in our day-to-day lives. In 2020, the COVID-19 pandemic only accelerated this trend, as many of us have moved to remote working and living environments and are now conducting more activities and communications online than ever before.

Despite this shift, if you're a broker or investment adviser operating in the United States, the regulatory default delivery method for important client communications continues to be paper. Of course, many (if not most) firms have chosen to ditch paper in favor of providing clients with a digital experience. The reasons for doing so are numerous – electronic delivery allows firms to save money, reduce their impact on the environment, automate and track delivery, engage more directly with clients, and other reasons we'll discuss a bit later.

That said, before you decide to go digital, the Securities and Exchange Commission (SEC) expects you to follow its guidance on the use of electronic media, which is found in a series of SEC releases published in 1995, 1996 and 2000 (the "SEC Releases").<sup>2</sup> The 1996 release in particular discusses how advisers and brokers may use electronic means to meet their legal obligations to deliver information to clients, such as the recently adopted Form CRS (Client Relationship Summary).

In this paper, we'll first distill that guidance so you can understand easily what the requirements are and build your policies and procedures accordingly. We'll then apply those requirements, using Form CRS as a case study, and explain in more detail the advantages that electronic delivery could offer your firm.

## The Four Factors from the SEC Releases

The SEC Releases provide the framework for using electronic delivery as a substitute for paper delivery, which they note is the default method of disseminating information to investors and clients. The SEC permits electronic delivery of client communications, including Form CRS, but only if your electronic method provides, in the SEC's view, an experience that is comparable to paper delivery. How do you know whether you've given your clients such an experience? The SEC focuses on four factors: notice, access, consent and recordkeeping. Let's break those factors down now.

### Notice

The SEC takes the position that proper notice is required when sending information electronically. But what does it mean to say that notice is "proper"? To start, the notice of an electronic communication to your clients should be timely and adequate. SEC guidance notes that when a client receives a communication through traditional mail, they are likely to realize that they have received important information that may require action. If a client receives the same information electronically, the SEC believes it is less likely that they will fully understand

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the critical nature of the communication or comprehend that action may be required on their part. It is important to note that the SEC does not define what constitutes “timely” delivery. However, taken within the context of the comparison to traditional mail delivery, your firm should consider its electronic delivery of client communications to be timely if distributed in a time frame comparable to traditional mail. With the theoretical understanding of the SEC’s guidance in mind, let’s turn to the practical application of what proper, timely and adequate notice looks like.

The SEC’s guidance on notice depends upon the medium of electronic delivery. If the means of electronic communication is “physical” in nature, the SEC interprets that the delivery of the communication itself is sufficient to satisfy the notice requirement. The SEC defines physical electronic communications to include email.

Notably absent from the definition of physical electronic delivery, however, is the dissemination of client communications through the use of a web portal or other static URL. In other words, if you intend to host client communications on your website, perhaps your firm has set up a unique client portal interface on its website or app; the SEC considers this a passive electronic delivery system and requires additional notice of the electronic delivery. To meet that requirement, you can set up your system to send an email to the client notifying them when a new communication is posted to their static client portal account. Simply adding new communications to a client portal or website without directly notifying clients of that addition will not satisfy your firm’s obligation to give proper notice.

## Access

Even if you’ve established proper notice, you must also provide your clients with adequate access to electronic communications. Similar to its position on notice, the SEC’s interpretive guidance on electronic communications discusses access in a comparative manner to traditional mail delivery. According to the SEC, the reason that traditional mail gives clients easy, consistent and reliable access to the important information being sent to them while also providing an essential opportunity to retain that information is the physical nature of its delivery. The SEC expects electronic communications to provide the same attributes.

So how does a firm satisfy these requirements? First, the means of electronic communication should not be so burdensome on your clients that it clearly impedes their access to the distributed information. The standard of ease should be equivalent to the client removing a letter from their physical mailbox and opening it to reveal its contents. If your firm communicates to clients through direct email, attaching the client communication to the email will satisfy the SEC’s guidance. If your firm communicates to clients through a secured client portal, as discussed above, the client’s access to that portal should be clear and obvious. The element of access would not be satisfied, for example, if the client received an email notice of a new document on the portal but no link to the portal was provided in the notice or if the portal access link is embedded within several layers of sub-pages on your firm’s website or app, which the client must seek out on their own. The SEC would likely interpret these types of scenarios as more burdensome on a client’s access to electronic information as compared to traditional mail delivery of the same information.

Second, proper access to electronically delivered information requires that the client have the same ability to permanently retain it as provided by traditional mail delivery. This element is easily satisfied by enabling functionality sufficient for the client to download or print all electronic communications provided by your firm. Electronic communications via email inherently satisfy this requirement so long as no restrictions on printing or downloading are embedded within the communication. Similarly, if your firm is utilizing a client portal, the client must be able to print or download that information for independent record retention. It is insufficient with respect to access to just maintain archiving functionality as part of the client's portal without giving the client the option to independently retain. The key is that the client must have the ability to independently retain information just as they would if the information had been distributed to them through traditional mail.

## Consent

So, let's say that you're satisfied that your proposed method of electronic delivery provides clients with timely and adequate notice that information is available, and that clients can access the information provided. Are you ready to hit "send"? Not quite yet.

Before you communicate electronically, the SEC expects you to obtain a client's consent to electronic delivery. There are two ways to meet this requirement: getting proof of access or obtaining a client's prior informed consent.

### PROOF OF ACCESS

You will be deemed to have obtained a client's consent to electronic delivery if your document distribution systems and procedures provide you with evidence that a client received the information, for example, by email return receipt or confirmation of accessing, downloading or printing. Some firms with the tech savvy required may prefer this method over that described below as it does not require the administrative step of seeking and obtaining a formal consent and processing revocations of consent. Note, however, that if you seek to rely on this method, you must revert to paper delivery for any client for whom you cannot document receipt.

### PRIOR INFORMED CONSENT

If you prefer to obtain a client's consent up front, note at the outset that it must be an "informed consent." Critically, informed consent is more than just asking a client to say yes. Consent can only be informed after a client has been told of the scope of the consent and the risks involved in giving it. In particular, the SEC expects that at a minimum, firms explain to clients:

- that the document provided will be available through a specific electronic medium and what that medium is;
- that there may be costs associated with electronic delivery;
- the duration and scope of the consent (i.e., whether the scope is indefinite and whether the consent applies to more than one document); and
- that the client has the right to revoke consent at any time and receive all covered documents in paper format.

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As stated above, these are the minimum requirements. However, you should consider all material information a client might need to make an informed decision about whether to accept electronic delivery. For example, your consent should explain the risks of accessing materials over the internet, advise clients of the need to maintain a valid email address, and notify clients that information sent will be subject to archival. In addition, consider separately posting an FAQ section on your website or app to remind clients that you will be sending information electronically, what that means, and how they can request more information from you.

Consider also the method you use to obtain consent. For example, it is likely more efficient to request consent when you onboard clients (they're likely completing multiple account opening forms anyway) than at a later time. If you onboard clients in person, have your representatives take the time to explain the consent to them and have them acknowledge their consent in writing. If you onboard clients online or through an app, you may choose to have them provide their consent in a pop-up window that appears before they execute your service contract. Whichever way you decide to proceed, as a best practice, obtain the consent as a separate step using a distinct document and maintain a record of receipt. Given that the SEC expects you to inform clients before obtaining their consent, it's best not to just bury the consent in your service contract.

So, what does this really look like when implemented? Well, to help you get started, attached as Appendix A is a sample consent form that you may want to tailor and use with your clients.

## Recordkeeping

In the SEC Releases, the SEC noted its expectation that firms employing electronic delivery methods adopt policies and procedures to evidence the satisfaction of the notice, access and consent requirements. Furthermore, rules under the Advisers Act and Exchange Act require investment advisers and brokers, respectively, to keep records of certain communications made to clients. In particular, Advisers Act Rule 204-2 requires, among other things, SEC-registered advisers to keep copies of securities recommendations, advertisements and records of the dates that firm brochures and Forms CRS are provided to clients and prospects. Similarly, Exchange Act Rules 17a-3 and 17a-4 require, among other things, SEC-registered brokers to keep records pertaining to communications regarding account holdings and customer agreements, as well as records of when Forms CRS and other regulatory disclosures are delivered.

Both the Advisers Act and Exchange Act recordkeeping rules permit advisers and brokers to store records electronically, but to do so, electronic storage systems must be designed in accordance with the rules' requirements. Generally speaking, this means that electronic storage will be permitted when the records are organized in a way that allows easy location, access and retrieval of a record and protections are put in place to ensure the records' authenticity. In addition, firms choosing to store records electronically should ensure that they are able to promptly provide a full and accurate copy of any record in response to a regulator's request, and that all electronically stored records are backed up.

Thus, before you send any electronic communication, not only should you be sure to have addressed the notice, access and consent obligations, you will want to have policies, procedures and systems in place to adequately capture and retain records of those communications. That way, next time a regulator knocks on your door, you'll be ready.

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# Electronic Delivery Value Proposition

To put these four requirements into perspective, let's explore the benefits of electronic delivery as it pertains to the latest investor disclosure, Form CRS. For many broker-dealers and RIAs, the process of creating the underlying content of this form and delivering it to clients is a cumbersome yet necessary requirement under Regulation Best Interest.

As quarter end approaches, you may be reflecting on ways to improve internal processes for statement and general disclosure delivery. While the SEC defaults to a physical delivery method, it does allow your firm to consider digital delivery if the above requirements are met and investor experience is comparable to paper delivery. Here are several key considerations as you weigh the pros and cons of digital and physical delivery.

## Improved Client Engagement

In today's hypercompetitive wealth management industry, with secular shifts in investor behavior and razor-thin margins, every client engagement is a branding opportunity. As you consider bolstering client and prospect engagement, you may want to critically evaluate whether physical mail delivery creates much, if any, engagement.

Looked at more closely, physical delivery may expose your firm to the potential of misdelivery, delays due to COVID-19, or having clients auto-discard and lose yet another physical disclosure document. In contrast, considering that more than 90% of adults in the United States are using the internet, digital delivery can create a much more seamless client engagement opportunity. In fact, the digital option can be much more engaging, as it can include messaging customized to a client or prospective client, including explanatory language about the document and an invitation for further engagement. The right technology solution can also be leveraged to help monitor proof of access. This can be used to not only tick the box with respect to the SEC's consent requirement, but also to monitor client engagement and evidence of document delivery.

## Document Management

In an era in which wealth management firms are investing in the next sleek technology-based client interface, inundating clients with paperwork is contrary to this progress. More profoundly, for many reps, physical delivery does not drive client interaction opportunities or deliver a competitive advantage for the wealth management firm.

Electronic delivery provides clients with immediate and continuous access to information. As outlined above, this aligns with the SEC's access requirement since accessing electronic communications is not burdensome on clients and provides the ability to permanently retain documents, just as provided by traditional mail delivery. Investors can opt in to receive electronic notices and access their accounts regardless of time or location, providing much desired flexibility and convenience. Just imagine the regulatory examination where you have to check the box on the delivery of Form CRS to your client base. Electronic delivery will allow your compliance function to quickly run that report and illustrate receipt of the documents.

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From a client perspective, electronic delivery shifts the user experience from managing paper to a well-organized display of information that can be stored for as long as the client desires. With paper disclosure, the client collects a stack of documents over time and is burdened with deciding which to keep and for how long.

## Manual Processes and Errors

Delivering Form CRS electronically will enable firms to eliminate tedious and expensive administrative elements of paper-based tracking and data retention. This includes time saved by operationalizing manual processes for printing, mailing, faxing and filing Form CRS. Electronic processing also avoids human error and the potential for compliance exceptions from traditional manual approaches. With the regulators keeping a close eye, mitigating opportunities for mistakes is a sound strategy for any wealth management firm.

## Updating Form CRS

The SEC requires firms to update and file Form CRS within 30 days of a material change made to the disclosure contained in the form, rendering the existing versions out of date and obsolete. More importantly, they must redeliver the updated Form CRS or any changes to clients within 60 days of an update. For many firms, the process of documenting the change, updating Form CRS with the new disclosure and having legal team(s) sign off will consume most of the 30-day window. More importantly, firms must highlight the changes made and redeliver the form to all existing clients (or otherwise communicate the changes). Adding to the challenge, the SEC requires storage of the Form CRS audit trail and delivery information, both of which require a secure, accessible document management and version control processes. As wealth management firms think through their current process, operationalizing a repeatable and automated process around the delivery of Form CRS will be important.

## Digital vs. Manual Recordkeeping

Regardless of the content of Form CRS, electronic storage of data provides a significantly improved filing and searchability system over the traditional paper approach. The SEC requires that the record of each Form CRS disclosure be stored in a compliant format for six years or more. As stated earlier, the SEC requires these records to be easily accessible when they request a copy.

The process from a physical recordkeeping perspective is highly cumbersome. Physical records must include mailing and delivery confirmations along with a manual log of all deliveries. Compared to a digital workflow of automated document documentation and record retention, a manual approach is clearly tedious, time-consuming and costly.

Digital delivery offers an additional advantage by giving immediate insight into a potential error or misdirected communication. With email delivery, the firm or the representative receives a soft bounce-back notification when the recipient is out of the office or temporarily unavailable, and a hard bounce notification if the email account is no longer in service.

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## Financial and Environmental

The dynamic and repeatable process of delivering Form CRS through electronic delivery offers financial and environmental benefits.

An economic analysis is not needed to recognize that there are tangible financial benefits to electronic delivery of Form CRS. Manual delivery involves the additive costs of printing, mailing and physical storage, as well as associated labor costs. Once the Form CRS has been created, electronic delivery costs approximately the same amount whether the firm sends the form to one client or a million.

Electronic delivery is a paperless process and aligns with increasingly important environmental considerations faced by firms. Depending on the solution deployed, a paperless Form CRS workflow can potentially be integrated into existing paperless workflows by making it a required step during new account opening.

Thanks to technological advances and ubiquitous internet access, firms today can shift to greater reliance on electronic delivery and record retention, allowing them to catch up with how more and more people expect to receive communications from service providers. The advantages of delivering Form CRS electronically are clear and illustrate how this method of client communication is highly preferable to paper-based delivery.

# Appendix A

## CONSENT TO ELECTRONIC DELIVERY OF DOCUMENTS

[Firm Name] (“we” or “us”) is [an investment adviser] [a broker-dealer] registered with the Securities and Exchange Commission (SEC).

**Acknowledgment.** By opening an account with us and clicking “I agree,” you are giving us your informed consent to electronic delivery of all Firm Communications (defined below). This means that you acknowledge that you have carefully read and understand the information provided below regarding electronic delivery of documents and that you agree to the conditions outlined below governing our electronic delivery of Firm Communications to you.

**Advisory Communications.** “Firm Communications” means account statements, notices, disclosures, regulatory communications, [trade confirmations] and other information and records regarding our services to you.

**Electronic Delivery.** We will deliver all Firm Communications to you by making them available to you when you log into your account on our website or mobile application (the “Interface”). If required by law, we will notify you by email when Firm Communications are posted on the Interface. Such notification may be sent directly by us through our email systems. All email notifications of Firm Communications will be sent to your email address of record. Firm Communications delivered electronically may be printed or downloaded by you and retained for your permanent records.

**Risks of Electronic Delivery.** You acknowledge that the internet is not a secure network and that communications transmitted over the internet may be accessed by unauthorized or unintended third parties. Emails on rare occasions may fail to transmit properly. In addition, factors beyond our control, such as server problems, may delay delivery or posting of a particular Firm Communication. Regardless of whether you receive an email notification, you agree to check the Interface regularly for up-to-date information.

**Costs.** We do not charge any fees for sending Firm Communications electronically. You acknowledge that you must bear any costs associated with accessing email, such as charges from internet access providers and telephone companies.

**Duration of Consent.** Your consent will be effective as of the date you open an account with us and will remain in effect until you revoke it. You understand that it may take up to [number] business days to process a revocation of consent to electronic delivery, and you may receive electronic notifications in the interim. If your consent is revoked, we will provide Firm Communications to you through non-electronic means.

**Valid Email Address.** You certify that the email address provided to us when you opened your account is your valid email address. You agree to maintain that email address and to continue to have access to the internet. If your email address changes from the one provided to us, you agree to immediately notify us of the new email address.

**Archival.** The SEC requires us to keep every client-related communication. Therefore, all emails we receive from you or send to you are subject to review and archival.

**Notifications and Support.** To revoke your consent or notify us of a change of your email address, or if you are unable to access your Firm Communications, please notify us through the Interface.

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