

TO: File Nos. S7-08-18  
FROM: Gena Lai, Division of Investment Management  
RE: Meeting with Representatives of Charles Schwab & Co.  
DATE: July 24, 2018

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On Tuesday, July 24, 2018, representatives of the Securities and Exchange Commission (“SEC”) participated in a meeting with representatives of Charles Schwab & Co. The Charles Schwab & Co. representatives present in person were Christopher Gilkerson and Jeff Brown. The SEC representatives present in person were Dalia Blass, Sarah ten Siethoff, Sara Cortes, Parisa Haghshenas, Benjamin Kalish, Elizabeth Miller, Brett Redfearn, Heather Seidel, Lourdes Gonzalez, Emily Russell, Alicia Goldin, Brad Bartels, Roni Bergoffen, Vanessa Countryman, Jennifer Juergens, Bridget Farrell, and Mattias Nilsson.

The participants discussed, among other things, the SEC’s proposed Form CRS. Representatives of Charles Schwab & Co. provided presentation materials, which are attached.

Proposed Regulation BI  
& Form CRS, and  
Comments on More RIA  
Regulations

July 24, 2018

# Schwab's Unique Perspective

## Who we are

- Dual registrant with exclusive focus on individual investors and those who serve them
- Over 40 years of experience communicating with retail investors
- “Through clients’ eyes” strategy
- Give investors access to broad choice about how, when, whether, and in what form they receive and pay for investment advice

## Business lines and perspective

- \$3.4 trillion in total client assets, 11 million active accounts
- Assets evenly divided between retail-direct, and services to independent RIAs
- Of the approximately \$1.7 trillion in retail-direct:
  - Majority is self-directed, some of whom want occasional investment advice
  - About 15% investment advisory (most also have at least one brokerage account)
- Reps are dually licensed, most are CFP professionals
- Transparent: provide clear explanations about how Schwab makes money, pays reps, has conflicts
- Undertook investor research looking across categories of BD and RIA to uncover what retail investors want and need (see some portions of that research below)

# Form CRS: Simplify, Shorten, Link to Additional Information

## June 14 Investor Advisory Committee Panel insights

- General support for a new BD common disclosure
- Panelist views were consistent with several Commissioners' concerns:
  - C. Peirce: "Disclosure overload is an issue for investors . . . a sterile compliance exercise that focuses on delivering a pile of documents . . . rather than engaging with the investor's needs"
  - C. Stein: "Both too generic and too legalistic such that retail investors won't bother to read it"
  - C. Jackson: "Will investors understand the implications of what they see on Form CRS?"

## Schwab insights from decades of experience (noted at panel)

- Stay focused (less is more)
- Unfold complexity in stages
- Make it visual
- Think digitally
- Be sparing with frequency

## Schwab-commissioned research

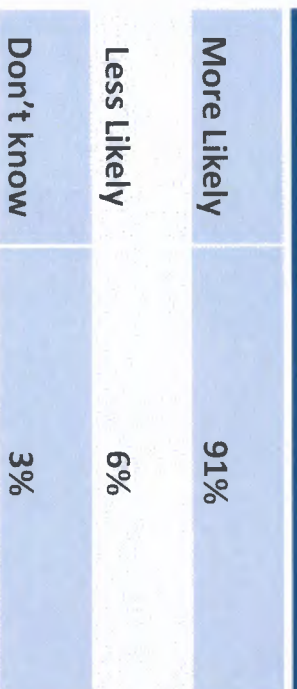
- Independent research firm (Koski) survey of 1,000 investors of all types fielded 6/10-15
- Main findings:
  - More likely to read/understand if shorter, focused, specific to them, visually appealing
  - 63% want disclosure at or before open account, with annual update, plus on web (not at time of investment advice)
  - 76% said deliver online or digital plus choice for paper (only 24% said paper)
  - Don't understand, mix-up scope of investment advice services BD or RIA provides



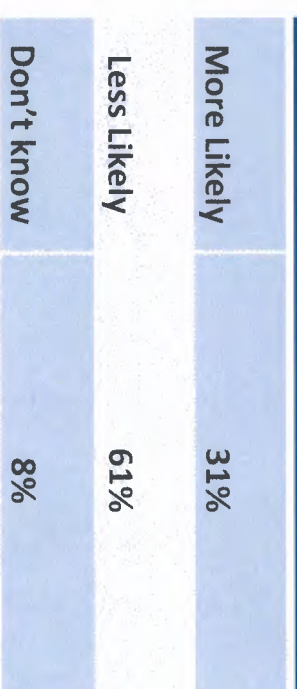
# Form CRS: Simplify, Shorten, Link to Additional Information

Would you be more or less likely to read a disclosure if it ...?

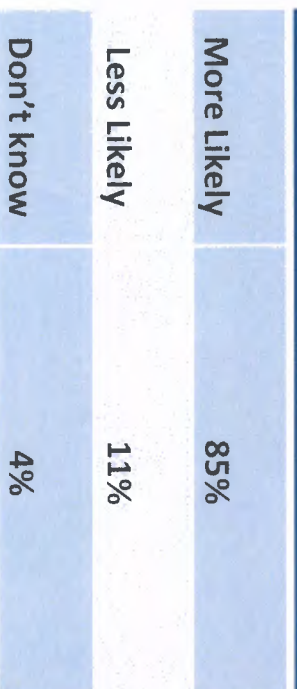
**Covered information relevant to me and my account**



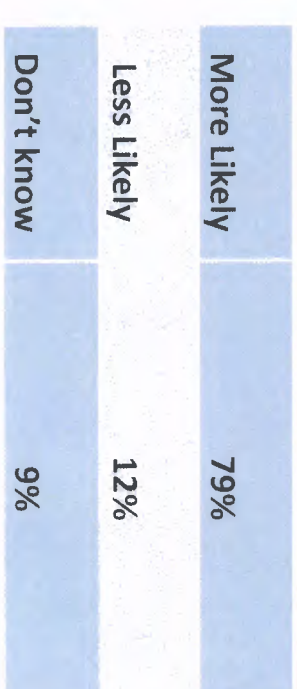
**Was longer and more comprehensive**



**Was short and to the point with links to more information if I want it**

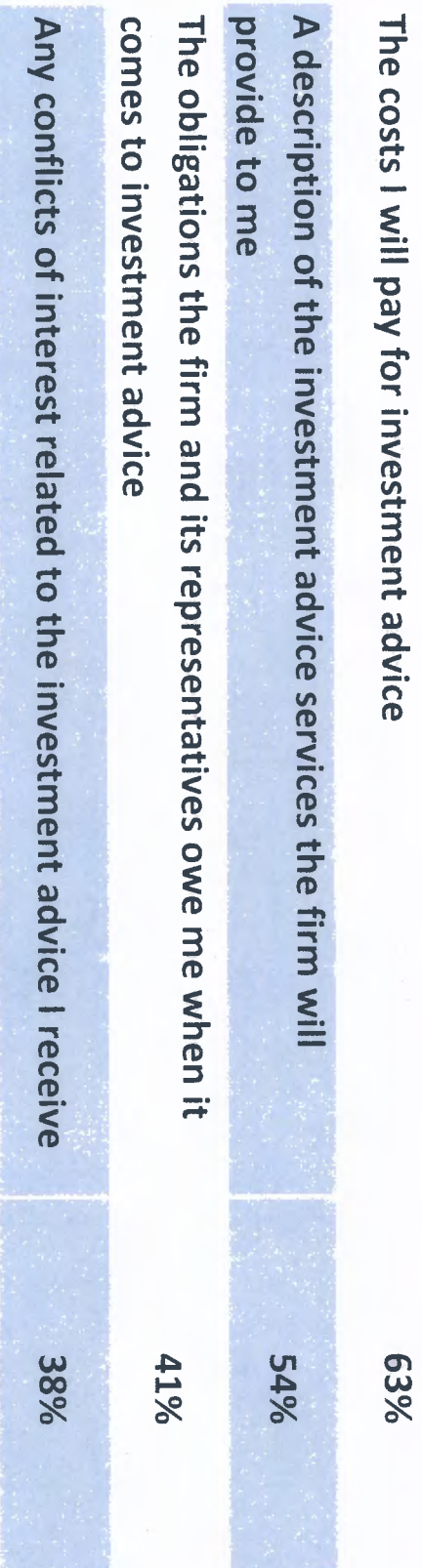


**Was visually appealing and did not seem like a legal document**



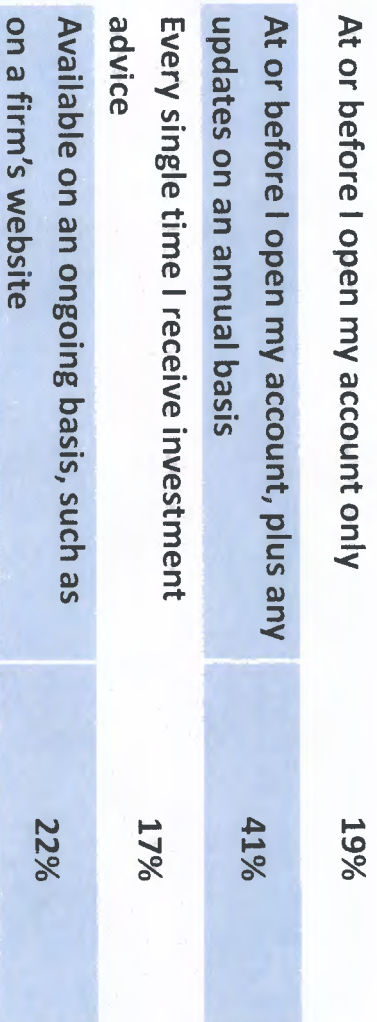
# Form CRS: Simplify, Shorten, Link to Additional Information

Assuming you are thinking about an account or relationship with a Brokerage Firm or a Registered Investment Advisor (RIA), which 4 of the following would be most important for that firm to communicate to you? [Top results presented below]

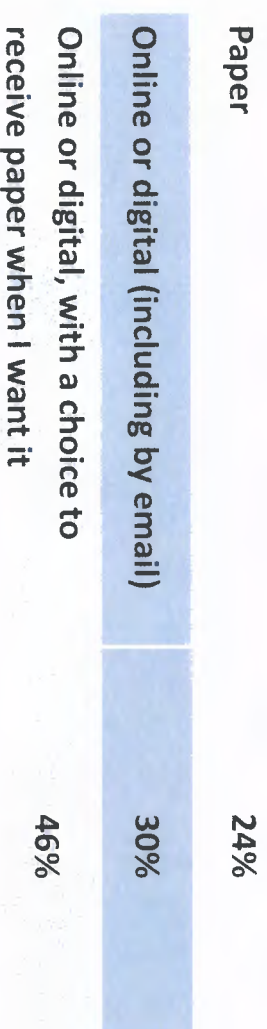


# Form CRS: Simplify, Shorten, Link to Additional Information

Which of the following best describes your preference for when you would like to receive information about how a Brokerage Firm or a Registered Investment Advisor (RIA) does business with you?



How would you prefer to receive disclosures about investment advice you would receive from a brokerage firm or investment advisory firm?



# Form CRS: Simplify, Shorten, Link to Additional Information

## Research indicates these revisions

- One page organized around questions to allow easier comparisons
- For RIAs, should be a cover page or navigation aid to ADV brochure
- Focus on one thing: the specific relationship the investor is in or contemplating
- Link to more information if an investor wants it, including general education
- Start with scope of investment advice service with obligations
- Remove item asking “what type of account is right for you?”
- Follow Pew approach, make it usable for digital
- See attached Schwab alternative in Appendix A

## Frequency and relation to Regulation BI

- At or before account open (and initial delivery to existing clients)
- Annual update and reminder, with link to access the current version
- Evergreen CRS on firm’s website (update within 30 days of material change)
- Relationship to Disclosure Obligation under Regulation BI:
  - At the time of transaction only if a material conflict regarding a particular investment recommendation has not already been covered
- If any more frequent, then investors will become numb to it



# Regulation BI: Harmonize Best Interest, Simplify and Clarify Disclosure

## Support Tailored Standard for BDs, with Caveat

- Upholds investor freedom of choice (no implication of continuous duty)
- Relies on settled definitions (e.g., “recommendation,” “suitability”)
- Allows development of appropriate guidance and precedent
- **But will not address investor confusion** unless make some changes

## Final Rule Should Meet Reasonable Investor Expectations

- Best interest standard generally should be the same except:
  - for BDs it is transactional
  - for RIAs it is continuous (depending on contractual obligations)
- Understand why not proposed as “Fiduciary,” but it really is and that’s fine
- Research shows that investors have general understanding of “fiduciary” and “best interest”
- But like legal experts, they have a hard time distinguishing between them
- Confused regarding the scope of the investment advice they will receive
- Take a look at the research . . .

# Regulation BI: Harmonize Best Interest, Simplify and Clarify Disclosure

When you see the phrase “act as your fiduciary” in the context of someone giving you investment advice, do you have an understanding about what this means?



When you see the phrase “act in your best interest” in the context of someone giving you investment advice, do you have an understanding about what this means?

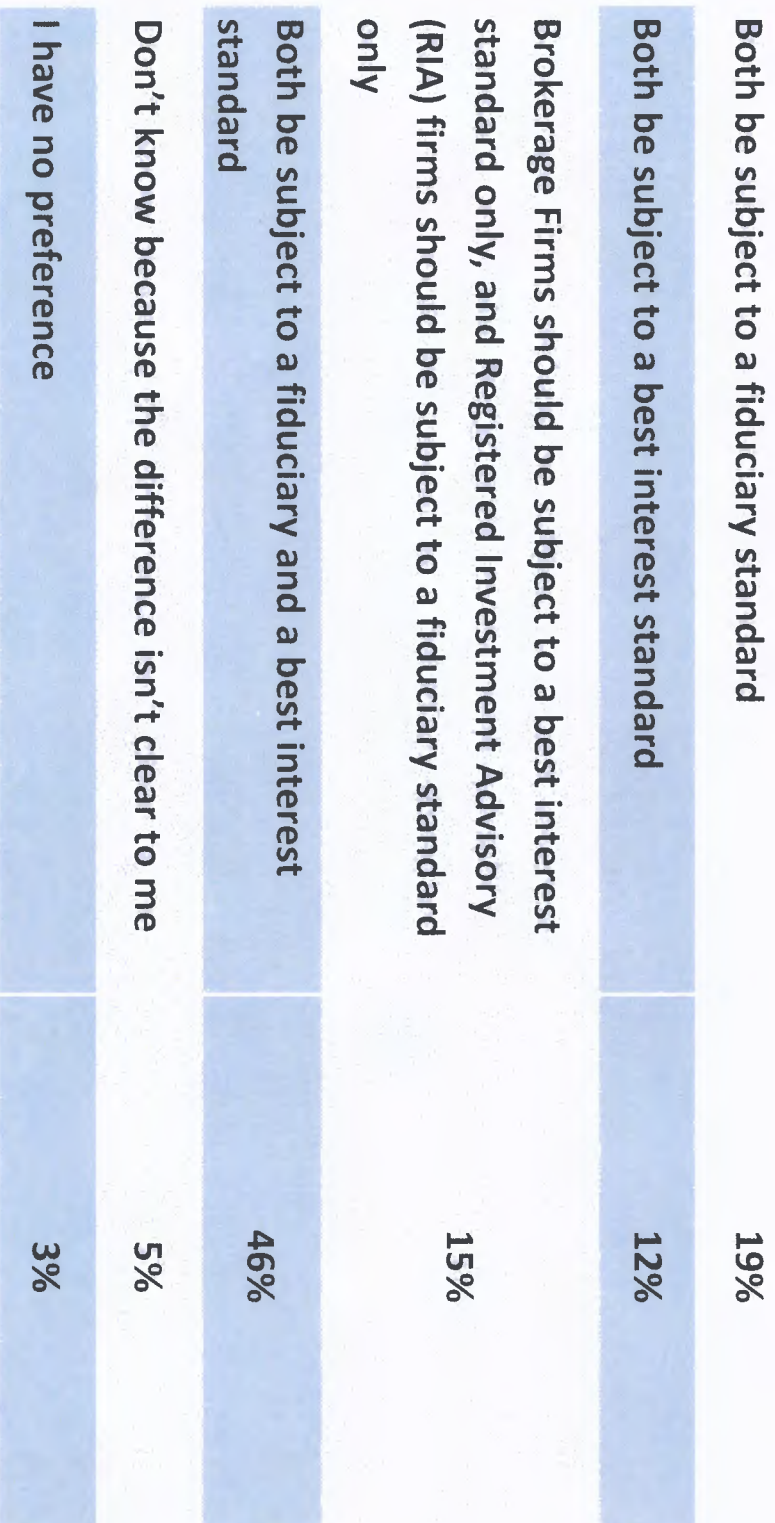


Acting as a “fiduciary” and acting in your “best interest” in the context of someone giving you investment advice should mean...?



# Regulation BI: Harmonize Best Interest, Simplify and Clarify Disclosure

Whether investment advice comes from a representative of a Brokerage Firm or a Registered Investment Advisor (RIA), do you think they should...?



# Regulation BI: Harmonize Best Interest, Simplify and Clarify Disclosure

Consistency is important

- Investors do not understand the nuances
- Dual hatted representatives (including CFP professionals) can't deal with differences
- Stay close to DOL impartial conduct standard (DOL may be down, but not out)
- Consider places to bring consistency between BDs and RIAs:
  - Statement of "best interest" standard
  - Guidance on conflicts of interest and mitigation (including neutral compensation)

## Regulation BI Disclosure Obligations

Disclosure  
Obligation – key assumptions

- Allows flexibility for each firm's business model
- "Reasonably disclose" standard is the right one
- Takes into account that many firms already have good disclosures in place
- Takes into account that many recommendations are over the phone

Harmonize with  
Form CRS  
layered  
disclosure

- Assume one-page CRS with links (see above and attached) that covers:
  - Capacity (one time is sufficient – more is not meaningful to investors)
  - Investment advice services with corresponding obligations
  - Fees and charges
  - Material conflicts of interest (rep and firm)
- No more is necessary unless not accurate for particular recommendation
- Otherwise, point of transaction disclosure too burdensome for clients, costly for firms

# No Case To Burden RIAs and Investors With Additional Prescriptive Rules

- No compelling evidence of enhanced investor protection: need data to quantify potential benefits exceed costs
- Would be costly
  - In response to 2013 Request for Data on imposing BD-like rules, Schwab commissioned an independent survey to collect data:
    - Set up + year one = 150% increase in RIA costs and over \$1B industry costs
    - Full results at: <https://www.sec.gov/comments/4-606/4606-3137.pdf>
  - Need this type of data to justify any new proposal
- Commission authority unclear: Dodd-Frank directed rulemaking regarding “existing standards of care for providing personalized investment advice”
  - 913 Study recommended consideration of rule harmonization but only if “add meaningful investor protection” and only listed one of three areas (licensing and continuing education)



# No Case To Burden RIAs and Investors With Additional Prescriptive Rules

## 1. Financial responsibility rules

- RIAs do not have same custody / asset responsibilities
- BD risks are not relevant risks
- “Serious fraud” addressed by Custody Rule, enhanced ADV requirements, and improved examination program

## 2. Licensing and Continuing Education

- State regime for licensing already in place
- NASAA is working on continuing education proposal
- No evidence of additional benefit for SEC to step-in

## 3. Account Statements with Fees

- No justified need
  - Investors already receive fee info on custodian account statement, or
    - Advisor bills directly
- Requiring two statements could be confusing to investors

# Appendix

- Alternative one-page Form CRS
- Annotated version
- Example of link to additional information in digital format

# A Summary of Your Brokerage Account Relationship with Charles Schwab & Co., Inc.

The purpose of this summary is to inform you about the nature of our relationship for this and other brokerage accounts you may have with Schwab. For more information, please go to [schwab.com/relationship](http://schwab.com/relationship).

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## What investment advice services do you provide and what are your obligations?

- If we give you investment advice such as recommending an investment or investing strategy, we will act in your best interest and not place our interests ahead of yours.
- You may invest on your own in this account without any advice from us.
- Even when we give you investment advice, you make the final decisions.
- We will not manage or monitor this or other brokerage accounts. Schwab offers investment advisory accounts, which include management of your investments for an ongoing fee. To inquire whether that type of account is right for you, talk to a Schwab representative or go to [schwab.com/investmentadvisory](http://schwab.com/investmentadvisory) to see a summary like this one for advisory accounts.

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## What are the fees and costs for investment advice?

- If you decide to buy or sell a stock, certain exchange-traded funds, mutual funds, or bonds, you will pay a commission or transaction fee. Other investments do not have a commission or transaction fee; instead, the price of the investment includes compensation for Schwab.
- The price you pay is the same whether we recommend an investment to you or not.
- For details on fees and pricing, please go to [schwab.com/pricing](http://schwab.com/pricing).

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## How does your firm make money from investment advice and what are its conflicts of interest?

- Schwab makes more money from some investments you may select compared to others, whether or not a Schwab representative recommends the investment to you.
- For example, Schwab and its affiliates earn more if you purchase a Schwab-affiliated mutual fund or exchange-traded fund than if you purchase one managed by another company.
- For a detailed explanation about how Schwab makes money depending on the investments you choose and our related conflicts of interest, go to [schwab.com/firmcomp](http://schwab.com/firmcomp).

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## How do you pay your professionals who give investment advice?

- We compensate our representatives who provide investment advice based on factors such as the amount of client assets they service and the time and complexity required to understand your needs, make recommendations, and provide services to you.
- We do not pay our representatives based on product sales commissions.
- For details on how we pay all of our representatives, please go to [schwab.com/repcomp](http://schwab.com/repcomp).

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## What additional information should I consider?

- For investor education information about different types of investing account relationships and services that may be available to you, and other questions you might want to consider, please visit [www.sec.investoreducation.gov](http://www.sec.investoreducation.gov)
- For free and simple tools to research our firm, our representatives, and other firms, including disciplinary events, please visit [investor.gov](http://investor.gov) and [brokercheck.finra.org](http://brokercheck.finra.org).

# Benefits of Alternate One-Page Approach to Form CRS

## Simple

Plain English, easy-to-read content in brief, one-page format.

- Covers key questions and provides answers
- Allows for easier comparison with other firms, as well as necessary tailoring

## Relevant

Focuses on the type of account an investor is in process of selecting (in this case, brokerage).

- Avoids confusion of mixing account types
- Instead, dual registrant links to summaries of advisory accounts
- Website version consolidates all linked information and enables download of comprehensive PDF

## Focused

Includes easy-to-understand information on the most important elements of the relationship:

- Services and corresponding obligations
- Fees and costs
- Conflicts of interest
- Additional information, including disciplinary history

## Layered

Q&A approach provides top-line answers on each topic area and links to more in-depth information on company website

## Visual

Employs a variation of the Pew disclosure format, making it easier for investors to find and follow information conveyed.

## Resourceful

Provides links to investor education materials and objective third-party sites.

SEC FORM CRS - INVESTOR EDUCATION

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- For free and simple tools to research our firm, our representatives, and other firms, including disciplinary events, please visit [investor.gov](http://investor.gov) and [brokercheck.fina.org](http://brokercheck.fina.org).

Illustrative – for discussion only

# A Layered Approach Leads To More Information

## Current Schwab Pricing Hub

Commissions & Trades | Account Fees | Index Fund Expenses | Transfer Money | Investment Advice | Common Questions | Open Your Account

### Commissions & Trades

[- Minimize All](#)

#### Stocks & ETFs

	Online Trades	Automated Phone Trades	Broker-Assisted Trades
Stocks <sup>110</sup>	\$4.95	\$4.95 + \$5.00 service charge	\$4.95 + \$25.00 service charge
Schwab ETF OneSource™	\$0	\$0 + \$5.00 service charge	\$0 + \$25.00 service charge
All other ETFs	\$4.95	\$4.95 + \$5.00 service charge	\$4.95 + \$25.00 service charge

Commissions & Trades | Account Fees | Index Fund Expenses | Transfer Money | Investment Advice | Common Questions | Open Your Account

### Investment Advice

[+ Expand All](#)

Automated Investing	Schwab Intelligent Portfolios <sup>®</sup>	<a href="#">+</a>
Personal Planning and Automated Investing	Schwab Intelligent Advisory™	<a href="#">+</a>
Dedicated Financial Advice	Schwab Private Client™ Schwab Advisor Network <sup>®</sup>	<a href="#">+</a>
Additional Solutions	Schwab Managed Portfolios Managed Accounts: Equity Strategies Managed Accounts: Fixed Income Strategies Windhaven <sup>®</sup> Strategies ThomasPartners <sup>®</sup> Strategies	<a href="#">+</a>

[www.schwab.com/public/schwab/investing/pricing\\_services/fees\\_minimums](http://www.schwab.com/public/schwab/investing/pricing_services/fees_minimums)