

conflict.<sup>92</sup> Further, we believe that any potential costs or market effects resulting from investment advisers addressing conflicts of interest may be decreased by the flexibility advisers have to meet their federal fiduciary duty in the context of the specific scope of services that they provide to their clients, as discussed in this Final Interpretation.

The commenter also drew particular attention to the question of whether the Commission's discussion of the fiduciary duty in the Proposed Interpretation applied to advisers to institutional clients as well as those to retail clients. The same commenter indicated that failing to accommodate the application of the concepts in the Proposed Interpretation to sophisticated clients could risk changing the marketplace or limiting investment opportunities for sophisticated clients, increasing compliance burdens for advisers to sophisticated clients, or chilling innovation. As explained above, this Final Interpretation, as compared to the Proposed Interpretation, discusses in more detail the ability of investment advisers and different types of clients to shape the scope of the relationship to which the fiduciary duty applies.<sup>93</sup> In particular, this Final Interpretation acknowledges that while advisers owe each of their clients a fiduciary duty, the specific obligations of, for example, an adviser providing comprehensive, discretionary advice in an ongoing

relationship with a retail client will be significantly different from the obligations of an adviser to an institutional client, such as a registered investment company or private fund, where the contract defines the scope of the adviser's services and limitations on its authority with substantial specificity.<sup>94</sup>

Finally, to the extent this Final Interpretation causes some investment advisers to reassess their compliance with their duty of loyalty, it could lead to a reduction in the expected profitability of advice relating to particular investments for which compliance costs would increase following the reassessment.<sup>95</sup> As a result, the number of investment advisers willing to advise a client to make these investments may be reduced. A decline in the supply of investment adviser advice regarding these types of investments could affect efficiency for investors; it could reduce the efficiency of portfolio allocation for those investors who might otherwise benefit from investment adviser advice regarding these types of investments and are no longer able to receive such advice. At the same time, if providing full and fair disclosure and appropriate monitoring for highly complex products (e.g., those with a complex payout structure, such as those that include variable or contingent payments or payments to multiple parties) results in these products becoming less profitable

for investment advisers, investment advisers may be discouraged from supplying advice regarding such products. However, investors may benefit from (1) no longer receiving inadequate disclosure or monitoring for such products, (2) potentially receiving advice regarding other, less complex or expensive products that may be more efficient for the investor, and (3) only receiving recommendations for highly complex or high cost products for which an investment adviser can provide full and fair disclosure regarding its conflicts and appropriate monitoring.

**List of Subjects in 17 CFR Part 276**

Securities.

**Amendments to the Code of Federal Regulations**

For the reasons set out above, the Commission is amending Title 17, chapter II of the Code of Federal Regulations as set forth below:

**PART 276—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT ADVISERS ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER**

- 1. Part 276 is amended by adding Release No. IA-5428 and the release date of June 5, 2019, to the end of the list of interpretive releases to read as follows"

Subject	Release No.	Date	FR vol. and page
* * * * *	* * * * *	* * * * *	* * * * *
Commission Interpretation Regarding Standard of Conduct for Investment Advisers.	IA-5248	June 5, 2019 .....	[Insert FR Volume Number] FR [Insert FR Page Number].

By the Commission.  
 Dated: June 5, 2019.  
**Vanessa A. Countryman,**  
*Acting Secretary.*  
 [FR Doc. 2019-12208 Filed 7-11-19; 8:45 am]  
**BILLING CODE 8011-01-P**

**SECURITIES AND EXCHANGE COMMISSION**  
**17 CFR Part 276**  
**[Release No. IA-5249]**  
**Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser**  
**AGENCY:** Securities and Exchange Commission.  
**ACTION:** Interpretation.  
**SUMMARY:** The Securities and Exchange Commission (the "SEC" or the "Commission") is publishing an

interpretation of a section of the Investment Advisers Act of 1940 (the "Advisers Act" or the "Act"), which excludes from the definition of "investment adviser" any broker or dealer that provides advisory services when such services are "solely incidental" to the conduct of the broker or dealer's business and when such incidental advisory services are provided for no special compensation.  
**DATES:** Effective July 12, 2019.  
**FOR FURTHER INFORMATION CONTACT:** James McGinnis, Senior Counsel, Investment Adviser Regulation Office, at (202) 551-6787 or *IArules@sec.gov*; and Benjamin Kalish, Attorney-Advisor, or

<sup>92</sup> See *supra* section II.C.  
<sup>93</sup> See *supra* footnotes 78-81 and accompanying text.  
<sup>94</sup> See *supra* section II.A.

<sup>95</sup> For example, such products could include highly complex, high cost products with risk and return characteristics that are hard for retail investors to fully understand, or where the

investment adviser and its representatives receive complicated payments from affiliates that create conflicts of interest that are difficult for retail investors to fully understand.

Parisa Haghshenas, Branch Chief, Chief Counsel's Office at (202) 551-6825 or [IMOCC@sec.gov](mailto:IMOCC@sec.gov), Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-8549.

**SUPPLEMENTARY INFORMATION:** The Commission is publishing an interpretation of the solely incidental prong of the broker-dealer exclusion in section 202(a)(11)(C) of the Advisers Act [15 U.S.C. 80b].<sup>1</sup>

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### I. Introduction

The Advisers Act regulates the activities of certain “investment advisers,” who are defined in section 202(a)(11) of the Advisers Act in part as persons who, for compensation, engage in the business of advising others about securities. Section 202(a)(11)(C) excludes from the definition of investment adviser—and thus from the application of the Advisers Act—a broker or dealer “whose performance of such advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation” for those services (the “broker-dealer exclusion”). The broker-dealer exclusion shows, on the one hand, that at the time the Advisers Act was enacted Congress recognized broker-dealers commonly provided some investment advice to their customers in the course of their business as broker-dealers and that it would be inappropriate to bring broker-dealers within the scope of the Advisers Act because of this aspect of their business.<sup>2</sup> On the other hand, the limitations of the exclusion show that Congress excluded broker-dealer advisory services from the scope of the Advisers Act only under certain circumstances—namely, when those services are solely incidental to the broker-dealer’s regular business as a

broker-dealer (the “solely incidental prong”) and when the broker-dealer receives no special compensation (the “special compensation prong”).<sup>3</sup>

On April 18, 2018, the Commission proposed a rulemaking intended to enhance the standard of conduct for broker-dealers when providing recommendations.<sup>4</sup> The Commission also proposed an interpretation intended to reaffirm and in some cases clarify the standard of conduct for investment advisers,<sup>5</sup> as well as a rulemaking intended to provide retail investors with clear and succinct information regarding key aspects of their brokerage and advisory relationships.<sup>6</sup> The Reg. BI Proposal discussed the broker-dealer exclusion and requested comment on the scope of the exclusion as applied to a broker-dealer’s exercise of investment discretion.<sup>7</sup> While some commenters addressed when a broker-dealer’s advisory services are “solely incidental to the conduct of his business as a broker or dealer” in the context of the exercise of investment discretion, more commenters addressed this prong more generally.<sup>8</sup> For example, many

<sup>3</sup> See *Regulation Best Interest*, Securities Exchange Act Release No. 83062 (April 18, 2018) [83 FR 21574 (May 9, 2018)] (“Reg. BI Proposal”), at n.343. The broker-dealer exclusion is conjunctive—that is, the broker-dealer must both provide investment advice that is solely incidental to the conduct of his business as a broker-dealer and the broker-dealer must receive no special compensation. In the event that a broker-dealer’s investment advice fits within the guidance of this Release with respect to the solely incidental prong, that broker-dealer must also receive no special compensation for the advisory service to be consistent with the broker-dealer exclusion.

<sup>4</sup> See *id.*  
<sup>5</sup> *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation*, Investment Advisers Act Release No. 4889 (April 18, 2018) [83 FR 21203 (May 9, 2018)] (the “Proposed Fiduciary Interpretation”).

<sup>6</sup> See *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles*, Investment Advisers Act Release No. 4888 (April 18, 2018) [83 FR 21416 (May 9, 2018)] (“Relationship Summary Proposal”). Concurrently with this interpretation, we also are adopting the final versions of the rules and interpretations proposed in the Relationship Summary Proposal, the Reg. BI Proposal, and the Proposed Fiduciary Interpretation. See *Form CRS Relationship Summary; Amendments to Form ADV*, Investment Advisers Act Release No. 5247 (June 5, 2019) (the “Relationship Summary Adoption”); *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Exchange Act Release No. 86031 (June 5, 2019) (“Reg. BI Adoption”); and *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Investment Advisers Act Release No. 5248 (June 5, 2019) (“Final Fiduciary Interpretation”).

<sup>7</sup> See Reg. BI Proposal, *supra* footnote 3, at nn.342-67 and accompanying text.

<sup>8</sup> We considered comments submitted in File No. S7-07-18 (Reg. BI Proposal, *supra* footnote 3); File

commenters requested general guidance on or expressed views about the meaning of the solely incidental prong<sup>9</sup> and the permissibility under this prong of various broker-dealer activities that relate to the investment advice they provide in light of the Reg. BI Proposal and the Relationship Summary Proposal.<sup>10</sup> Other commenters suggested that our approach to the Reg. BI Proposal was inconsistent with the solely incidental prong of the broker-dealer exclusion. One commenter suggested that the Reg. BI Proposal, if adopted, would allow broker-dealers to provide investment advice beyond what the solely incidental prong should “reasonably be interpreted to permit,” arguing that to qualify for exclusion from regulation under the Advisers Act, broker-dealers should only “be able to provide very limited advice. . . .”<sup>11</sup> Two commenters thought that the Commission’s expressed support for maintaining the “broker-dealer model as an option for retail customers seeking investment advice”<sup>12</sup> was inconsistent with the solely incidental prong.<sup>13</sup>

No. S7-08-18 (Relationship Summary Proposal, *supra* footnote 6); and File No. S7-09-18 (Proposed Fiduciary Interpretation, *supra* footnote 5). Those comments are available on the Commission’s website at <https://www.sec.gov/comments/s7-07-18/s70718.htm>, <https://www.sec.gov/comments/s7-08-18/s70818.htm>, and <https://www.sec.gov/comments/s7-09-18/s70918.htm>, respectively.

<sup>9</sup> See, e.g., Comment Letter of North American Securities Administrators Association, Inc. (Aug. 23, 2018) (“NASAA Letter”); Comment Letter of CFA Institute (Aug. 7, 2018) (“CFA Institute Letter”) (noting the “need to give guidance” on the broker-dealer exclusion and noting that the Commission has legal authority to provide needed clarification); Comment Letter of the Institute for the Fiduciary Standard (Aug. 6, 2018) (“IFS Letter”) (arguing that when a broker’s investment advice is solely incidental to its business is one of a number of “questions the SEC should address”); Comment Letter of the Consumer Federation of America (Aug. 7, 2018) (“CFA Letter”) (arguing that the Commission failed to “engage” on “just how far the ‘solely incidental’ exclusion stretches”); Comment Letter of the Investment Adviser Association (Aug. 6, 2018) (“IAA Letter”) (“[T]he Commission should reconsider when broker-dealers should be able to rely on the Solely Incidental [prong].”); Comment Letter of Michael Kitces (Aug. 2, 2018) (“Kitces Letter”) (arguing that the Commission’s prior interpretations of the solely incidental prong are inconsistent with the plain meaning and legislative history of the term).

<sup>10</sup> See, e.g., CFA Letter; Kitces Letter.

<sup>11</sup> See NASAA Letter.

<sup>12</sup> See Reg. BI Proposal, *supra* footnote 3, at text accompanying n.31.

<sup>13</sup> See CFA Letter (stating that certain aspects of the Relationship Summary Proposal and the Reg. BI Proposal indicated that broker-dealers were in an “advice relationship” in a manner that does not “remotely sound like advice that is ‘solely incidental to’ the conduct of their business as a broker or dealer”); Kitces Letter (arguing that referring to the broker-dealer model as a “model for advice” is in contravention of the broker-dealer exclusion because “advice can only be incidental if it occurs by chance, as a consequence of a product sale, or without intent to give advice”).

<sup>1</sup> 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified.

<sup>2</sup> *Opinion of General Counsel Relating to Section 202(a)(11)(C) of the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 2 (Oct. 28, 1940) (“Advisers Act Release No. 2”).

Another commenter called the Commission's previously articulated interpretation of the solely incidental prong "vague."<sup>14</sup> The comments we received demonstrate that there is disagreement about when the provision of broker-dealer investment advice is consistent with the solely incidental prong.<sup>15</sup> In light of these comments, we are adopting this interpretation to confirm and clarify the Commission's position with respect to the solely incidental prong. To illustrate how the interpretation functions, we discuss its application to two advisory services that a broker or dealer may provide, namely: (i) Exercising investment discretion over customer accounts and (ii) account monitoring.<sup>16</sup> Our interpretation complements each of the rules and forms we are adopting, which, among other things, are intended individually and collectively to enhance investor understanding of the relationships and services offered by investment advisers and broker-dealers.<sup>17</sup>

<sup>14</sup> See Comment Letter of Securities Arbitration Clinic, St. Vincent DePaul Legal Program, Inc., St. John's University School of Law (Aug. 7, 2018) ("St. John's Clinic Letter").

<sup>15</sup> Furthermore, interested parties have for years expressed their views to the Commission on what they believe the broker-dealer exclusion requires, including disagreements with the Commission's interpretation of the exclusion. See, e.g., Comment Letter of Consumer Federation of America (Sept. 20, 2004) (arguing that the Commission should "define 'solely incidental' in a way that hews closely to what commenters described as Congress's clear intent to provide only a very narrow exclusion"), available at <https://www.sec.gov/rules/proposed/372599/s72599-1101.pdf>.

<sup>16</sup> We received comments requesting guidance with respect to the solely incidental prong on both activities. See *infra* section ILC.

<sup>17</sup> See Reg. BI Adoption; Relationship Summary Adoption; Final Fiduciary Interpretation, *supra* footnote 6. We also received a few comments in response to the Reg. BI Proposal and the Relationship Summary Proposal requesting that the Commission provide guidance on the special compensation prong. See, e.g., CFA Letter (arguing, among other points, that special compensation would constitute any compensation other than commissions for trade execution); Comment Letter of Coalition of Mutual Fund Investors (Aug. 8, 2018) ("Mutual Fund Investors Letter") (arguing that special compensation should include all asset-based compensation and third-party fees from mutual funds and their advisers). We are not providing guidance on the special compensation prong in this Release as we do not believe our views on this prong require additional clarification. The Commission has considered the meaning of the special compensation prong on previous occasions. See, e.g., *Interpretive Rule Under the Advisers Act Affecting Broker-Dealers*, Investment Advisers Act Release No. 2652 (Sept. 24, 2007) ("2007 Proposing Release"); *Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Investment Advisers Act Release No. 2376 (Apr. 12, 2005) ("2005 Adopting Release," in which, as discussed *infra* at footnote 38 and accompanying text, the Commission adopted a rule that a court vacated on grounds that did not address our interpretive positions relating to the solely incidental prong). The comments we received in response to requests for comment to the

## II. Interpretation and Application

### A. Historical Context and Legislative History

When the Advisers Act was enacted in 1940, broker-dealers regularly provided investment advice.<sup>18</sup> They did so in two distinct ways: As an auxiliary part of traditional brokerage services for which their brokerage customers paid fixed commissions and, alternatively, as a distinct advisory service for which their advisory clients separately contracted and paid a fee.<sup>19</sup> The advice that broker-dealers provided as an auxiliary component of traditional brokerage services was referred to as "brokerage house advice" in a leading study of the time.<sup>20</sup> "Brokerage house advice" was extensive and varied,<sup>21</sup> and included information about various corporations, municipalities, and governments;<sup>22</sup> broad analyses of

Reg. BI Proposal and the Relationship Summary Proposal did not demonstrate that there is significant disagreement with our interpretation of that prong.

<sup>18</sup> For an extensive discussion of broker-dealer practice in the years leading up to enactment of the Advisers Act, from which this summary is drawn, see 2005 Adopting Release, *supra* footnote 17; *Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Investment Advisers Act Release No. 2340 (Jan. 6, 2005) ("2005 Proposing Release").

<sup>19</sup> See, e.g., *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Committee on Banking and Currency*, 76th Cong., 3d Sess. 736 (1940) ("Hearings on S. 3580") (testimony of Dwight C. Rose, president of the Investment Counsel Association of America) ("Most . . . investment dealers . . . and brokers advise on investment problems, either as an auxiliary service without charge, or for specific charges allocated to this specific function.").

<sup>20</sup> See Twentieth Century Fund, *The Security Markets* (1935) ("Security Markets") at 633–46 (discussing "brokerage house advice"); see also Charles F. Hodges, *Wall Street* (1930) ("Wall Street") at 253–85; SEC, *Report on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services* (1939) (H.R. Doc. No. 477) ("Investment Counsel Report") at n.1.

<sup>21</sup> See, e.g., Report of Public Examining Bd. on Customer Protection to N.Y. Stock Exchange (Aug. 31, 1939), at 3: The customer entrusts the broker with information regarding his financial affairs and dealings which he expects to be kept in strict confidence. Frequently he looks to the broker to perform a whole series of functions relating to the investment of his funds and the care of his securities. Although he could secure similar services at his bank, he asks his broker, as a matter of choice and convenience, to hold credit balances of cash pending instructions; to retain securities in safekeeping and to collect dividends and interest; to advise him respecting investments; and to lend him money on suitable collateral.

<sup>22</sup> *Security Markets*, *supra* footnote 20, at 633; *Wall Street*, *supra* footnote 20, at 254 ("This information includes current and comparative data for a number of years on earning and earnings records, capitalization, financial position, dividend record, comparative balance sheets and income statements . . . production and operating statistics, territory and markets served, officers and directors

general business and financial conditions;<sup>23</sup> market letters and special analyses of companies' situations;<sup>24</sup> information about income tax schedules and tax consequences;<sup>25</sup> and "chart reading."<sup>26</sup> The second way in which broker-dealers dispensed advice was to charge a distinct fee for advisory services, which typically were provided through special "investment advisory departments" within broker-dealer firms that advised customers for a fee in the same manner as firms whose sole business was providing "investment counsel" services.<sup>27</sup>

Between 1935 and 1939, the Commission conducted a congressionally mandated study of investment trusts and investment companies and in connection with this study surveyed investment advisers, including broker-dealers with investment advisory departments.<sup>28</sup> In a report to Congress (the "Investment Counsel Report"), the Commission informed Congress that the Commission's study had identified two broad classes of problems relating to investment advisers that warranted legislation: "(a) The problem of distinguishing between bona fide investment counselors and 'tipster' organizations; and (b) those problems involving the organization and operation of investment counsel

of the company and much other information of value to the investor in appraising the value of a security.").

<sup>23</sup> *Security Markets*, *supra* footnote 20, at 634; *Wall Street*, *supra* footnote 20, at 254.

<sup>24</sup> *Security Markets*, *supra* footnote 20, at 640–43; *Wall Street*, *supra* footnote 20, at 277–85.

<sup>25</sup> *Security Markets*, *supra* footnote 20, at 641.

<sup>26</sup> *Id.* at 643 (defining "chart reading" as "the study of the charted course of prices and volume of trading over a long period of time in order to discover typical conformations recurring in the past with sufficient frequency to be utilized in the present as a basis of judgment as to impending price changes").

<sup>27</sup> See *Advisers Act Release No. 2*, *supra* footnote 2; see also *Security Markets*, *supra* footnote 20, at 646, 653 (referring to "investment supervisory departments" and "special investment management departments" of broker-dealers). In general, contemporaneous literature used the term "investment counsel" or "investment counselor" to refer to those who provided investment advice for a fee and whose advisory relationship with clients had a supervisory or managerial character. See *id.* at 646 (defining "investment counselor" as "an individual, institution, organization, or department of an institution or organization which undertakes for a fee to advise or to supervise the investment of funds by, and on occasion to manage the investment accounts of, clients"). Under the Advisers Act, "investment counsel" is a defined subset of the "investment advisers" to whom the Act applies. See section 208(c) of the Act.

<sup>28</sup> *Investment Counsel Report*, *supra* footnote 20, at 1. The study was conducted pursuant to section 30 of the Public Utility Holding Company Act of 1935 [15 U.S.C. 79z–4]; see *Hearings on S. 3580*, *supra* footnote 19, at 995–96.

institutions.”<sup>29</sup> Based on the findings of the Investment Counsel Report, representatives of the Commission testified at the congressional hearings on what ultimately became the Advisers Act in favor of regulating the persons engaged in the business of providing investment advice for compensation.

Congress responded by passing the Advisers Act. Section 202(a)(11) of the Act defined “investment adviser”—those subject to the requirements of the Act—broadly to include “any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. . . .” In adopting this broad definition, Congress necessarily rejected arguments presented during its hearings that legitimate investment counselors<sup>30</sup> should be free from any oversight except, perhaps, by the few states that had passed laws regulating investment counselors and by private organizations, such as the Investment Counsel Association of America.<sup>31</sup> Instead, in responding to such views, congressional committee members repeatedly observed that those whose business was limited to providing investment advice for compensation were subject to little if any regulatory oversight, and questioned why they should not be subject to regulation even though other professionals were.<sup>32</sup>

<sup>29</sup> Investment Counsel Report, *supra* footnote 20, at 27.

<sup>30</sup> Hearings on S. 3580, *supra* footnote 19, at 745–48; *see also* 2005 Adopting Release, *supra* footnote 17, at n.62.

<sup>31</sup> Hearings on S. 3580, *supra* footnote 19, at 716–18, 736–38, 740–41, 744–45, 760, 763.

<sup>32</sup> *Id.* at 738–39, 745–49, 751–53 (Senators Wagner and Hughes). David Schenker, chief counsel for the Commission’s study, offered the following observations in response to investment counselors’ arguments against the registration and regulation required by the Act: Then there is another curious thing, Senator, that those people who are subject to supervision by some authoritative body of some kind, such as securities dealers or investment bankers have to register with us as brokers and dealers. People, who are brokers and members of stock exchanges and are supervised by the stock exchanges. Curiously enough, the people in the investment-counsel business who are supervised are not eligible for membership in the investment counsel association; because the association says that if you are in the brokerage or banking business you cannot be a member of the association. So the situation is that if you take their analysis, the only ones who would not be subject to regulation by the SEC, would be the people who are not subject to regulation by anybody at all. These investment counselors who appeared here are no different from the over-the-counter brokers and dealers or the members of the New York Stock Exchange. *Id.* at 995–96. Eventually, members of the

Conversely, the Advisers Act specifically excluded persons, among others, from the broad definition of “investment adviser” to the extent that such persons rendered investment advice incidental to their primary business.<sup>33</sup> Broker-dealers were among these excluded persons, as section 202(a)(11)(C) of the Act excludes from the definition of “investment adviser” a broker-dealer who provides investment advice that is “solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor”—*i.e.*, the broker-dealer exclusion.

#### *B. Scope of the Solely Incidental Prong of the Broker-Dealer Exclusion*

The Commission and its staff have on several occasions discussed the scope of the broker-dealer exclusion.<sup>34</sup> In adopting a rule regarding fee-based brokerage accounts in 2005, for example, the Commission stated that investment advisory services are “solely incidental to” the conduct of a broker-dealer’s business when the services are offered in connection with and are reasonably related to the brokerage services provided to an account.<sup>35</sup> The interpretation was consistent with the Commission’s contemporaneous construction of the Advisers Act as excluding broker-dealers whose investment advice is given “solely as an

investment counsel industry agreed with the proposed legislation. *See id.* at 1124; *Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the House Committee on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. (1940) (“Hearings on H.R. 10065”); *see also* S. Rep. No. 76–1775, 76th Cong., 3d Sess. 21 (1940); H.R. Rep. No. 76–2639, 76th Cong., 3d Sess. 27 (1940).

<sup>33</sup> The exclusion for certain professionals in Advisers Act section 202(a)(11) is very similar to certain state-law provisions governing investment counselors at the time, which excepted “brokers, attorneys, banks, savings and loan associations, trust companies, and certified public accountants.” *See* Statutory Regulation of Investment Advisers (prepared by the Research Department of the Illinois Legislative Council) reprinted in Hearings on S. 3580, *supra* footnote 19, at 1007. That report stated that “the investment advice furnished by these excepted groups would seem to be merely incidental to some other function being performed by them.” *Id.*

<sup>34</sup> *See, e.g.*, Advisers Act Release No. 2, *supra* footnote 2; *Applicability of the Investment Advisers Act to Certain Brokers and Dealers; Interpretation of the Term ‘Special Compensation’*, Investment Advisers Act Release No. 640 (Oct. 5, 1978); *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987).

<sup>35</sup> 2005 Adopting Release, *supra* footnote 17; 2005 Proposing Release, *supra* footnote 18.

incident of their regular business.”<sup>36</sup> The 2005 interpretation stated that the importance or frequency of the investment advice was not a determinant of whether the solely incidental prong was satisfied; the Commission rejected the view that only minor, insignificant, or infrequent advice qualifies for the broker-dealer exclusion, noting that the advice broker-dealers gave as part of their brokerage services in 1940 was often substantial and important to customers.<sup>37</sup>

On March 30, 2007, the Court of Appeals for the District of Columbia Circuit in *Financial Planning Association v. SEC* vacated the rule regarding fee-based brokerage accounts, but not on grounds that addressed our interpretive positions relating to the solely incidental prong.<sup>38</sup> In September 2007, we proposed to reinstate these interpretive positions.<sup>39</sup>

Since that time, a federal appellate court has addressed the solely incidental prong. In 2011, in *Thomas v. Metropolitan Life Insurance Company*, the Court of Appeals for the Tenth Circuit addressed the scope of the broker-dealer exclusion in the context of a private suit alleging that a broker had violated the Advisers Act by failing to disclose incentives to sell proprietary products.<sup>40</sup> As part of its analysis of the exclusion, the court looked to the interpretation of the solely incidental prong that we advanced in 2005 and 2007. The court found these interpretations to be “persuasive” in light of its own analysis of the text of the solely incidental prong of the broker-dealer exclusion as well as the legislative history and historical background of the Advisers Act.<sup>41</sup> The court concluded that a broker-dealer’s investment advice is solely incidental to its conduct as a broker-dealer if the advice is given “only in connection with the primary business of selling securities.”<sup>42</sup> Thus, the court explained, “broker-dealers who give advice that is not connected to the sale of securities—or whose primary business consists of giving advice—do not meet the [solely incidental] prong” of the broker-dealer exclusion.<sup>43</sup> The court also agreed with the Commission’s interpretations that the solely incidental prong does not

<sup>36</sup> *See* Advisers Act Release No. 2, *supra* footnote 2; *see also* 2005 Adopting Release, *supra* footnote 17.

<sup>37</sup> *See* 2005 Adopting Release, *supra* footnote 17, at nn.139–42 and accompanying text.

<sup>38</sup> *See* 482 F.3d 481 (D.C. Cir. 2007).

<sup>39</sup> 2007 Proposing Release, *supra* footnote 17.

<sup>40</sup> 631 F.3d 1153 (10th Cir. 2011).

<sup>41</sup> *Id.* at 1163–64.

<sup>42</sup> *Id.* at 1164.

<sup>43</sup> *Id.*

hinge upon “the quantum or importance” of a broker-dealer’s advice but on its relationship to the broker-dealer’s primary business.<sup>44</sup> In the court’s view, “[t]he quantum or importance of the broker-dealer’s advice is relevant only insofar as the advice cannot supersede the sale of the product as the ‘primary’ goal of the transaction or the ‘primary’ business of the broker-dealer.”<sup>45</sup>

Based on the text and history of the solely incidental prong, our previous interpretations of the prong, the *Thomas* decision, and the comments we have received, we are providing the following interpretation.<sup>46</sup> We interpret the statutory language to mean that a broker-dealer’s provision of advice as to the value and characteristics of securities or as to the advisability of transacting in securities<sup>47</sup> is consistent with the solely incidental prong if the advice is provided in connection with and is reasonably related to the broker-dealer’s primary business of effecting securities transactions.<sup>48</sup> If a broker-dealer’s primary business is giving advice as to the value and characteristics of securities or the advisability of transacting in securities, or if the advisory services are not offered in connection with or are not reasonably related to the broker-dealer’s business of effecting securities transactions, the broker-dealer’s

advisory services are not solely incidental to its business as a broker-dealer.<sup>49</sup> Whether advisory services provided by a broker-dealer satisfy the solely incidental prong is assessed based on the facts and circumstances surrounding the broker-dealer’s business, the specific services offered, and the relationship between the broker-dealer and the customer.

The quantum or importance of investment advice that a broker-dealer provides to a client is not determinative as to whether or not the provision of advice is consistent with the solely incidental prong. Advice need not be trivial, inconsequential, or infrequent to be consistent with the solely incidental prong. Indeed, our simultaneous adoption of (i) Regulation Best Interest, which raises the standard of conduct that applies to broker-dealer recommendations, and (ii) the relationship summary, which provides information about broker-dealer recommendation services to customers, underscores that broker-dealer investment advice can be consequential even when it is offered in connection with and reasonably related to the primary business of effecting securities transactions.

To illustrate the application of this interpretation in practice, we provide the following guidance on the application of the interpretation to (i) exercising investment discretion over customer accounts and (ii) account monitoring.

### C. Guidance on Applying the Interpretation of the Solely Incidental Prong

#### 1. Investment Discretion

The Commission has for many years considered issues related to a broker-dealer’s exercise of investment discretion over customer accounts and the extent to which such practices could be considered solely incidental to the business of a broker-dealer.<sup>50</sup> The Commission has stated that discretionary brokerage relationships “have many of the characteristics of the relationships to which the protections of

the Advisers Act are important.”<sup>51</sup> In particular, the Commission has explained that when a broker-dealer exercises investment discretion, it is not providing *advice* to customers that is in connection with and reasonably related to effecting securities transactions; rather, the broker-dealer is making investment *decisions* relating to the purchase or sale of securities on behalf of customers on an ongoing basis.<sup>52</sup> At the same time, the Commission has taken the position that some limited exercise of discretionary authority by broker-dealers could be considered solely incidental to their business.<sup>53</sup>

We requested comment in the Reg. BI Proposal on a broker-dealer’s exercise of investment discretion over customer accounts and the extent to which the exercise of investment discretion should be considered solely incidental to the business of a broker-dealer.<sup>54</sup> Commenters agreed that the exercise of unlimited discretion should not be considered “solely incidental” investment advice.<sup>55</sup> Commenters expressed varying views, however, on the extent to which the exercise of temporary or limited discretion could be considered solely incidental to the business of a broker-dealer. Several commenters suggested that the exercise of any investment discretion should be governed by the Advisers Act.<sup>56</sup> One commenter suggested that the Commission should interpret the solely incidental prong through the lens of the definition of “investment discretion” in section 3(a)(35) of the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>57</sup> noting that section 3(a)(35)

<sup>44</sup> *Id.* at 1163.

<sup>45</sup> *Id.* at 1166. In *Thomas*, the brokerage firm’s representative had conducted an analysis of the plaintiffs’ financial situation and advised them to purchase a particular financial product based in part on that analysis. The plaintiffs alleged that the firm’s policy “required [representatives] to provide investment advice to potential customers as a means to sell more proprietary products” and that this policy was “so pervasive that [representatives] allegedly gave financial advice to every customer to whom they sold a product.” *Id.* at 1157. The Court rejected the plaintiffs’ contention that these facts rendered the advice so central to the transaction that it could not be considered “solely incidental” to it. Because the representative’s advice “was closely related to the sale of the [product] and selling the [product] was the primary object of the transaction,” the Court concluded, the advice was “solely incidental” to the representative’s conduct as a broker. *Id.* at 1167.

<sup>46</sup> To the extent that this interpretation is inconsistent with the Commission’s prior interpretations with respect to the solely incidental prong, this interpretation supersedes those interpretations.

<sup>47</sup> See Advisers Act section 202(a)(11) (definition of “investment adviser”).

<sup>48</sup> *Cf.* 2005 Adopting Release, *supra* footnote 17 (“In general, investment advice is ‘solely incidental’ to the conduct of a broker-dealer’s business within the meaning of section 202(a)(11)(C) and to ‘brokerage services’ provided to accounts . . . when the advisory services rendered are in connection with and reasonably related to the brokerage services provided.”). We have modified the wording of our interpretation to make clear that the broker-dealer’s primary business must also be effecting securities transactions.

<sup>49</sup> Nothing in this interpretation alters the Commission’s 2006 interpretation of section 28(e) of the Exchange Act, which, in the context of a client commission arrangement that otherwise satisfies section 28(e), permits a broker-dealer to be paid out of a pool of commissions for its research even if that broker-dealer did not effect a securities transaction. See Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 54165 (July 18, 2006), 71 FR 41978 (July 24, 2006).

<sup>50</sup> See Reg. BI Proposal, *supra* footnote 3, at nn.343–62 and accompanying text.

<sup>51</sup> *Final Extension of Temporary Exemption from the Investment Advisers Act for Certain Brokers and Dealers*, Investment Advisers Act Release No. 626 (Apr. 27, 1978) (“Advisers Act Release No. 626”).

<sup>52</sup> See 2005 Proposing Release, *supra* footnote 18.

<sup>53</sup> See Reg. BI Proposal, *supra* footnote 3, at nn.355–62 and accompanying text. *Cf.* NASD rule 2510 (allowing discretion only if a customer “has given prior written authorization to a stated individual or individuals . . . in accordance with [FINRA] rule 3010”).

<sup>54</sup> See Relationship Summary Proposal, *supra* footnote 6, at nn.363–67 and accompanying text; see also *id.* at nn.343–62 and accompanying text for a description of the Commission’s historical approaches.

<sup>55</sup> See, e.g., Comment Letter of Financial Planning Coalition (Aug. 7, 2018) (“FPC Letter”) (“[A] broker-dealer’s provision of unfettered discretionary investment advice should never be considered ‘solely incidental’ to its business as a broker-dealer.” (emphasis removed)); CFA Letter; IFS Letter.

<sup>56</sup> See, e.g., Comment Letter of Invesco Advisers, Inc. (Aug. 7, 2018) (“Discretionary management over an account, whether or not temporary, is not within the scope of the ‘solely incidental’ exclusion.”); IAA Letter; CFA Institute Letter.

<sup>57</sup> Under Exchange Act section 3(a)(35), a person exercises “investment discretion” with respect to

focuses on “the level of authority, decision-making ability, influence—and ultimately, control—an intermediary has over another’s money” and arguing that those with section 3(a)(35) investment discretion have a heightened likelihood of mismanagement and abuse of another’s money.<sup>58</sup> Another commenter suggested that, while discretion generally should subject a broker-dealer to the Advisers Act, there are certain cases where temporary or limited discretion does not have the supervisory or managerial character of the investment discretion warranting the protections of the Advisers Act.<sup>59</sup>

Applying our interpretation of the solely incidental prong, a broker-dealer’s exercise of unlimited discretion<sup>60</sup> would not be solely incidental to the business of a broker-dealer consistent with the meaning of section 202(a)(11)(C).<sup>61</sup> It would be inconsistent with the solely incidental prong for broker-dealers to exercise “investment discretion” as that term is defined in section 3(a)(35) of the Exchange Act with respect to any of its accounts, except for certain instances of investment discretion granted by a customer on a temporary or limited

an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder. 15 U.S.C. 78c(a)(35).

<sup>58</sup> See FPC Letter (noting also that several federal and state courts have used factors similar to those in section 3(a)(35) to impose a fiduciary standard). Another commenter also suggested using Exchange Act section 3(a)(35) “investment discretion” as a basis for establishing whether discretion is not solely incidental for purposes of the broker-dealer exclusion, with an exception for investment discretion “that a customer grants on a temporary or limited basis.” See Comment Letter of Pickard Djinis and Pisarri (Aug. 14, 2018) (“Pickard Letter”).

<sup>59</sup> See Comment Letter of the Securities Industry and Financial Markets Association (Aug. 7, 2018) (“SIFMA Letter”).

<sup>60</sup> We view unlimited investment discretion as a person having the ability or authority to buy and sell securities on behalf of a customer without consulting the customer—*i.e.*, having responsibility for a customer’s trading decisions.

<sup>61</sup> The Commission has in the past stated that the quintessentially supervisory or managerial character of investment discretion warrants the protection of the Advisers Act. See *Amendment and Extension of Temporary Exemption from the Investment Advisers Act for Certain Brokers and Dealers*, Investment Advisers Act Release No. 471 (Aug. 20, 1975); see also 2005 Proposing Release, *supra* footnote 18; 2005 Adopting Release, *supra* footnote 17.

basis, as discussed below. A broker-dealer with unlimited discretion to effect securities transactions possesses ongoing authority over the customer’s account indicating a relationship that is primarily advisory in nature; such a level of discretion by a broker-dealer is so comprehensive and continuous that the provision of advice in such context is not incidental to effecting securities transactions.

We recognize, however, that there are situations where a broker-dealer may exercise temporary or limited discretion in a way that is not indicative of a relationship that is primarily advisory in nature. Generally, these are situations where the discretion is limited in time, scope, or other manner and lacks the comprehensive and continuous character of investment discretion that would suggest that the relationship is primarily advisory. The totality of the facts and circumstances would be relevant to determining whether temporary or limited discretion is consistent with the solely incidental prong. Taking into consideration specific examples that commenters have suggested in the past, instances of temporary or limited investment discretion that, standing alone, would not support the conclusion that a relationship is primarily advisory—and therefore outside the scope of the solely incidental prong—include discretion: (i) As to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite amount or quantity of a specified security; (ii) on an isolated or infrequent basis, to purchase or sell a security or type of security when a customer is unavailable for a limited period of time; (iii) as to cash management, such as to exchange a position in a money market fund for another money market fund or cash equivalent;<sup>62</sup> (iv) to purchase or sell securities to satisfy margin

<sup>62</sup> Certain changes to money market fund regulation and operations have been implemented since our prior interpretations. See *Money Market Fund Reform; Amendments to Form PF*, Investment Company Act Release No. 31166 (Jul. 23, 2014) (removing an exemption that permitted institutional non-government money market funds to maintain a stable net asset value, while maintaining such exemption for certain other money market funds, and applying certain fees and gates reforms to institutional non-government money market funds and retail money market funds but not to government money market funds, among other changes). In light of these changes, differently categorized money market funds may have different investment characteristics. Accordingly, we anticipate that FINRA will be reviewing the application of the rules that apply to the exercise of broker-dealer discretion in this context. The Commission staff also will evaluate broker-dealer exercise of discretionary cash management to consider whether additional measures may be necessary.

requirements, or other customer obligations that the customer has specified; (v) to sell specific bonds or other securities and purchase similar bonds or other securities in order to permit a customer to realize a tax loss on the original position; (vi) to purchase a bond with a specified credit rating and maturity; and (vii) to purchase or sell a security or type of security limited by specific parameters established by the customer. We view these examples of temporary or limited discretion as typically consistent with the broker-dealer exclusion because they are in connection with and reasonably related to a broker-dealer’s business of effecting securities transactions and do not suggest that the broker-dealer’s primary business is providing investment advice.

We have previously described a similar list of situations that we would consider temporary or limited discretion that may be consistent with the solely incidental prong.<sup>63</sup> We make three refinements.

First, we are not including authority for a period “not to exceed a few months” relating to the time a broker-dealer may purchase or sell a security or type of security when a customer is unavailable for a limited period of time. Depending on the facts and circumstances, a period of discretion lasting a few months may be indicative of a business or customer relationship that is primarily advisory in nature.

Second, we would view it as consistent with our interpretation of the solely incidental prong for broker-dealers to purchase or sell securities to satisfy margin requirements, *or other customer obligations that the customer has specified* (new wording italicized). In our view, there may be similar obligations to a broker-dealer or a third party whereby a broker-dealer may be authorized to make a purchase or sale, such as a sale to satisfy a collateral call.

Third, we would view it as consistent with our interpretation of the solely incidental prong for broker-dealers to sell specific bonds *or other securities* in order to permit a customer to realize a tax loss on the original position (new wording italicized). We see no distinction between bonds or other securities in this particular context.

## 2. Account Monitoring

We received several comments regarding the extent to which a broker-dealer may monitor the status and

<sup>63</sup> See 2005 Adopting Release, *supra* footnote 17, at nn.178–81 and accompanying text; 2007 Proposing Release, *supra* footnote 17, at n.13 and accompanying text.

performance of a customer's account while relying on the broker-dealer exclusion. Some commenters suggested that a broker-dealer's agreement to provide ongoing monitoring for the purpose of recommending changes to a customer's investments is not an advisory service that is solely incidental to the primary securities transaction business of a broker-dealer and thus the broker-dealer exclusion should not be available to broker-dealers who provide such services.<sup>64</sup> Another commenter suggested that broker-dealers providing personalized investment advice about securities on an ongoing basis should not be able to rely on the broker-dealer exclusion.<sup>65</sup> Commenters also suggested that providing services that cause overseen assets to meet the definition of "regulatory assets under management" under Form ADV (*i.e.*, securities portfolios for which the broker-dealer provides "continuous and regular supervisory or management services") should subject a broker-dealer to the Advisers Act.<sup>66</sup>

We disagree with commenters who suggested that *any* monitoring of customer accounts would not be consistent with the solely incidental prong. A broker-dealer that agrees to monitor<sup>67</sup> a retail customer's account on a periodic basis for purposes of providing buy, sell, or hold recommendations may still be considered to provide advice in connection with and reasonably related to effecting securities transactions.<sup>68</sup> In

contrast, when a broker-dealer, voluntarily and without any agreement with the customer, reviews the holdings in a retail customer's account for the purposes of determining whether to provide a recommendation to the customer—and, if applicable, contacts that customer to provide a recommendation based on that voluntary review—the broker-dealer's actions are in connection with and reasonably related to the broker-dealer's primary business of effecting securities transactions. Absent an agreement with the customer (which would be required to be disclosed pursuant to Regulation Best Interest), we do not consider this voluntary review to be "account monitoring."<sup>69</sup>

We decline to delineate every circumstance where agreed-upon monitoring is and is not solely incidental to a broker-dealer's brokerage business. Broker-dealers may consider adopting policies and procedures that, if followed, would help demonstrate that any agreed-upon monitoring is in connection with and reasonably related to the broker-dealer's primary business of effecting securities transactions. For example, broker-dealers may include in their policies and procedures that a registered representative may agree to monitor a customer's account at specific time frames (*e.g.*, quarterly) for the purpose of determining whether to provide a buy, sell, or hold recommendation to the customer.<sup>70</sup>

purchase, sell, or hold a security each time the agreed-to monitoring occurs and would be covered by Regulation Best Interest. *See id.* ("For example, if a broker-dealer agrees to monitor the retail customer's account on a quarterly basis, the quarterly review and each resulting recommendation to purchase, sell, or hold, will be a recommendation subject to Regulation Best Interest.")

In agreeing to provide any monitoring services, broker-dealers should also consider that a broker-dealer that separately contracts or charges a separate fee for advisory services is providing investment advice that is inconsistent with the broker-dealer exclusion. *See, e.g.*, 2005 Adopting Release, *supra* footnote 17. Broker-dealers should also consider that, even where such monitoring is consistent with the solely incidental prong, the broker-dealer must also receive no special compensation for the activity to be eligible for the broker-dealer exclusion. Broker-dealers receive special compensation where there is a clearly definable charge for investment advice. *See* Advisers Act Release No. 626, *supra* footnote 51; *see also* Advisers Act Release No. 2, *supra* footnote 2; 2007 Proposing Release, *supra* footnote 17 (describing this interpretation as the Commission's "longstanding view").

<sup>69</sup> *See* Reg. BI Adoption, *supra* footnote 6, at section II.B.2.b. Any recommendation made to the retail customer as a result of such voluntary review would be subject to Regulation Best Interest. *See id.*

<sup>70</sup> As noted in the Reg. BI Adoption, and consistent with the relationship summary adopted in the Relationship Summary Adoption, the scope and frequency of a broker-dealer's monitoring is a

material fact relating to the type and scope of services provided to a retail customer and thus is required to be disclosed under Regulation Best Interest. *See id.* at section II.B.2; *cf.* Relationship Summary Adoption, *supra* footnote 6. A broker-dealer disclosing to a customer that the broker-dealer will provide monitoring constitutes an agreement to monitor. *See supra* footnote 67.

However, such policies and procedures should not permit a broker-dealer to agree to monitor a customer account in a manner that in effect results in the provision of advisory services that are not in connection with or reasonably related to the broker-dealer's primary business of effecting securities transactions, such as providing continuous monitoring.<sup>71</sup> Additionally, dually registered firms may similarly consider adopting policies and procedures that distinguish the level and type of monitoring in advisory and brokerage accounts.<sup>72</sup>

The Commission will consider further comment on its interpretation of the solely incidental prong of the broker-dealer exclusion and its application to certain brokerage activities to evaluate whether additional guidance might be appropriate in the future. Based on any comments received, the Commission may, but need not, supplement this interpretation.

### III. Economic Considerations

The Commission's interpretation above is intended to advise the public of its understanding of the solely incidental prong of the broker-dealer exclusion. The interpretation does not itself create any new legal obligations for broker-dealers. Nonetheless, the

material fact relating to the type and scope of services provided to a retail customer and thus is required to be disclosed under Regulation Best Interest. *See id.* at section II.B.2; *cf.* Relationship Summary Adoption, *supra* footnote 6. A broker-dealer disclosing to a customer that the broker-dealer will provide monitoring constitutes an agreement to monitor. *See supra* footnote 67.

<sup>71</sup> The two examples of advisory services we discuss in this Release—investment discretion and monitoring—cannot be viewed and interpreted in isolation. For example, it would not be consistent with the solely incidental prong for a broker-dealer to exercise unlimited investment discretion over a customer account even if its monitoring activities do comport with the solely incidental prong. Thus, any policies and procedures that a broker-dealer adopts to ensure that the broker-dealer's activities are in connection with and reasonably related to the broker-dealer's primary business of effecting securities transactions similarly should not grant the broker-dealer the ability or authority to buy and sell securities on behalf of a customer as part of periodic account monitoring, except in circumstances of temporary or limited discretion that would be consistent with the solely incidental prong, as discussed above.

<sup>72</sup> In the Final Fiduciary Interpretation, we note that investment advisers may consider whether written policies and procedures relating to monitoring would be appropriate under Advisers Act rule 206(4)–7. *See* Final Fiduciary Interpretation, *supra* footnote 6, at section II.B.3.

Additionally, the Reg. BI Adoption confirms that a dual registrant is an investment adviser solely with respect to those accounts for which a dual registrant provides investment advice or receives compensation that subjects it to the Advisers Act. *See* Reg. BI Adoption, *supra* footnote 6, at section II.B.3.d. Determining the capacity in which a dual registrant is making a recommendation is a facts and circumstances test. *See id.*

<sup>64</sup> *See* FPC Letter ("[B]roker-dealers that enter into agreements with retail customers to provide ongoing monitoring for purposes of recommending changes in investments should be considered investment advisers and subject to fiduciary obligations under the Advisers Act. Entering into an agreement to provide ongoing monitoring. . . goes beyond advice that is solely incidental to the conduct of business as a broker-dealer. . . ."); IAA Letter (same quotation as the FPC Letter); IAA Letter ("[A] broker-dealer that agrees to provide a retail customer ongoing monitoring for purposes of recommending changes in investments would not be providing services that are solely incidental to its business as a broker-dealer under the 2007 interpretation."); Fisher Letter ("Brokers can give ongoing investment advice. . . yet still not be required to register as an investment adviser. . . . [T]he boundaries [between brokers and investment advisers] have practically been erased.")

<sup>65</sup> *See* Mutual Fund Investors Letter ("[The SEC] should. . . subject broker-dealers to the Advisers Act when they are providing personalized investment advice about securities on an ongoing basis. . . . The term 'solely incidental' should be interpreted narrowly and only include personalized investment advice that is one-time, temporary, or limited in scope.")

<sup>66</sup> *See* IAA Letter; Pickard Letter.

<sup>67</sup> The guidance in this section applies when a broker-dealer agrees to monitor a customer's account. *See* Reg. BI Adoption, *supra* footnote 6, at section II.B.2 for a discussion of what constitutes such an agreement.

<sup>68</sup> *See id.* Monitoring agreed to by the broker-dealer would result in a recommendation to

Commission recognizes that to the extent a broker-dealer's practices are not consistent with this interpretation of the solely incidental prong, the interpretation could have potential economic effects. We discuss these effects below.

#### A. Background

The Commission's interpretation regarding the solely incidental prong of the broker-dealer exclusion would affect broker-dealers and their associated persons as well as the customers of those broker-dealers, and the market for financial advice more broadly.<sup>73</sup> As of December 2018, there were approximately 3,764 registered broker-dealers with over 140 million customer accounts. In total, these broker-dealers have over \$4.3 trillion in total assets, which are total broker-dealer assets as reported on Form X-17a-5.<sup>74</sup> Of the broker-dealers registered with the Commission as of December 2018, 363 broker-dealers were dually registered with the Commission as investment advisers.<sup>75</sup> Dual registrant firms hold over 90 million (63%) of the overall 140 million customer accounts held by broker dealers.<sup>76</sup> As part of the Reg. BI Proposal, we requested data and other information related to the nature and magnitude of discretionary services offered by broker-dealers,<sup>77</sup> but did not receive any data or information to inform our analysis of potential

<sup>73</sup> See Relationship Summary Adoption, *supra* footnote 6, at section IV.B (discussing the market for financial advice generally).

<sup>74</sup> Assets are estimated by Total Assets (allowable and non-allowable) from Part II of the FOCUS filings (Form X-17A-5 Part II, available at [https://www.sec.gov/files/formx-17a-5\\_2.pdf](https://www.sec.gov/files/formx-17a-5_2.pdf)) and correspond to balance sheet total assets for the broker-dealer. The Commission does not have an estimate of the total amount of customer assets for broker-dealers. We estimate broker-dealer size from the total balance sheet assets as described above.

<sup>75</sup> For purposes of this analysis, a dual registrant is any firm that is dually registered with the Commission as an investment adviser and a broker-dealer. Because this number does not include the number of broker-dealers who are also registered as state investment advisers, the number undercounts the full number of broker-dealers that operate in both capacities.

<sup>76</sup> Some broker-dealers may be affiliated with investment advisers without being dually registered. From Question 10 on Form BD, 2,098 broker-dealers report that directly or indirectly, they either control, are controlled by, or under common control with an entity that is engaged in the securities or investment advisory business. Comparatively, 2,691 (19.57%) SEC-registered investment advisers report an affiliate that is a broker-dealer in Section 7A of Schedule D of Form ADV, including 1,916 SEC-registered investment advisers that report an affiliate that is a registered broker-dealer. Approximately 74% of total assets under management of investment advisers are managed by these 2,691 investment advisers.

<sup>77</sup> See Reg. BI Proposal, *supra* footnote 3.

economic effects stemming from this interpretation.

#### B. Potential Economic Effects

Broker-dealers currently incur ongoing costs related to compliance with their legal and regulatory obligations, including costs related to understanding their practices and structuring their practices to be consistent with the solely incidental prong of the broker-dealer exclusion. This interpretation generally confirms the scope of the solely incidental prong of the broker-dealer exclusion.

Generally, we believe that few, if any, broker-dealers take the view that they act consistently with the solely incidental prong with respect to any accounts over which the broker-dealer exercises more than temporary or limited investment discretion.<sup>78</sup> As with other circumstances in which the Commission speaks to the legal obligations of regulated entities, we acknowledge that affected firms, including those whose practices are consistent with the Commission's interpretation, incur costs to evaluate the Commission's interpretation and assess its applicability to them. Further, to the extent certain broker-dealers currently understand the scope of permissible monitoring or other permissible advisory activities under the solely incidental prong to be different from what is set forth in this interpretation, there could be some economic effects.<sup>79</sup>

This interpretation may produce economic effects to the extent that it causes any broker-dealers to recognize that their practices are inconsistent with the solely incidental prong and to adjust their practices to make them consistent. In particular, broker-dealers that have interpreted the solely incidental prong to conduct more advisory activities than this interpretation permits may choose

<sup>78</sup> See Comment Letter of UBS (noting that broker-dealers have existing arrangements where they exercise temporary or limited discretion, such as discretion as to time and price, and that those types of discretion "do not present the sort of risks about which the SEC is concerned with respect to the exercise of *unfettered discretion*") (emphasis added); SIFMA Letter (noting that there are instances in which temporary or limited discretion, such as discretion as to prices at which securities can be purchased, does not have the supervisory or managerial character of the investment discretion warranting the protections of the Advisers Act).

<sup>79</sup> The above application of our interpretation of the solely incidental prong to the exercise of investment discretion is generally consistent with the position taken in the 2005 Adopting Release and preliminarily taken in the 2007 Proposing Release. We believe that many broker-dealers changed their practices with respect to investment discretion in light of those releases, and thus those practices likely are consistent with our interpretation of the solely incidental prong.

to no longer provide such services to customers. This could result in a loss of certain customers, a reduction in certain business activities, and could preclude those broker-dealers from further developing certain services for their customers, except to the extent those broker-dealers are dually registered firms and their customers are also advisory clients. This may, in turn, result in decreased competition in the market for certain services, increased fees for those services, or a diminished number of broker-dealers offering commission-based services to investors.<sup>80</sup>

To the extent any broker-dealers have been providing advisory services beyond the scope of this interpretation, their customers may receive fewer advisory services if these broker-dealers choose not to register as investment advisers and adjust their business practices in light of this interpretation. To the extent that this interpretation would lead to a decline in the supply of certain services offered by broker-dealers (or a decline in broker-dealers offering services to particular customers), it could reduce the efficiency of portfolio construction for those investors who might otherwise benefit from broker-dealers providing investment advice with respect to their account and would find similar advice from investment advisers to be too costly or unattainable (e.g., due to account minimum requirements). For example, certain broker-dealers may incur costs to adopt or revise policies and procedures to ensure that the account monitoring that they may agree to provide their customers is consistent with this interpretation and may choose instead to stop offering such monitoring services. Further, to the extent that any broker-dealers determine that their services are not consistent with this interpretation, they may choose to register as investment advisers with the Commission, or one or more states, as applicable. Such broker-dealers would bear costs in choosing to register as investment advisers to continue providing those services, and their clients may face higher fees as a result. Alternatively, broker-dealers that have investment adviser affiliates may seek to place existing customers in advisory accounts instead of brokerage accounts.

Broker-dealers that determine they must change business practices as a

<sup>80</sup> For example, to the extent that broker-dealers respond to the interpretation by limiting the levels of discretion that they provide for their customers, execution quality (including the execution price) may be affected due to the delays encountered when the broker-dealer must contact a customer to proceed with a transaction.



result of this interpretation will choose their responses based on their circumstances. For example, if broker-dealers with affiliated advisers are able to utilize their existing regulatory infrastructure and compliance policies and procedures to account for activities that are inconsistent with the solely incidental exclusion they may face lower costs associated with migration of brokerage accounts and activities to investment advisory accounts. By contrast, we expect the costs of regulatory registration and compliance to be greater for any standalone broker-dealers that choose to become registered investment advisers, as they are more likely to need to undertake new systems, procedures, and policies.

To the extent that broker-dealers choose to discontinue providing certain services, register as investment advisers, or encourage migration of customer's brokerage accounts to advisory accounts of affiliates, this interpretation could result in a shift in the demand for the services of different types of financial

service providers, decreasing the demand for services of broker-dealers and increasing the demand for the services of investment advisers.<sup>81</sup>

This interpretation may also produce some overall economic effects to the extent that it causes any broker-dealers that to date have avoided performing limited discretion and other activities to recognize that they may perform such activities consistent with the solely incidental prong of the broker-dealer exclusion. Such broker-dealers may respond to this interpretation by increasing the amount of limited discretionary services or monitoring services that they agree to provide to their customers. Investors that have established relationships with such broker-dealers may benefit from more efficient access to these services and may demand these services from broker-dealers rather than becoming clients of investment advisers. While additional provision of these services by broker-dealers also raises the risk of regulatory arbitrage because similar activities

would be regulated under different regimes, we believe this risk will be mitigated by the adoption of rules that enhance the standard of conduct that applies to broker-dealer recommendations.

**List of Subjects in 17 CFR Part 276**  
Securities.

**Amendments to the Code of Federal Regulations**

For the reasons set out above, the Commission is amending title 17, chapter II of the Code of Federal Regulations as set forth below:

**PART 276—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT ADVISERS ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER**

- 1. Part 276 is amended by adding Release No. IA-5249 and the release date of June 5, 2019, to the end of the list of interpretive releases to read as follows:

Subject	Release No.	Date	FR vol. and page
* * *	* * *	* * *	* * *
Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser.	IA-5249	June 5, 2019 .....	[Insert FR Volume Number] FR [Insert FR Page Number]

By the Commission.

Dated: June 5, 2019.

**Vanessa A. Countryman,**  
*Acting Secretary.*

[FR Doc. 2019-12209 Filed 7-11-19; 8:45 am]

**BILLING CODE 8011-01-P**

<sup>81</sup>To the extent this interpretation results in altered compliance costs for standalone broker-dealers, non-affected standalone broker-dealers (*i.e.*, those standalone broker-dealers that already are in compliance with the solely incidental prong as we have interpreted it), dual registrants, investment

advisers, and other financial intermediaries that are not required to register as investment advisers (such as banks, trust companies, insurance companies, commodity trading advisers, and municipal advisors) may to a varying degree gain business at these affected broker-dealers' expense.