IAA Staff Analysis: SEC Standards of Conduct Rulemaking

After two decades of deliberations, the SEC on June 5 issued its Standards of Conduct rulemaking package, which is intended to raise the standard of conduct for broker-dealers, reaffirm the fiduciary duty under the Advisers Act, and reduce investor confusion as to the services offered by and standards applicable to their financial professional. The IAA has long advocated that all financial professionals who provide investment advice about securities to clients should be required to act in their clients' best interest pursuant to fiduciary principles.

The four parts to the rulemaking include:

- **Advisers Act Fiduciary Duty Interpretation** for Investment Advisers
- **Regulation Best Interest (Reg BI)** for broker-dealers when they make recommendations to retail customers, intended to strengthen the broker-dealer standard of conduct
- **Form CRS** (Part 3 of Form ADV to be delivered to retail investors), required for investment advisers, broker-dealers, and dually-registered firms
- **Solely Incidental Interpretation** regarding the broker exclusion from the definition of investment adviser

Effective Dates. The Advisers Act fiduciary duty and solely incidental interpretations will be effective immediately upon their publication in the *Federal Register*. Reg BI and Form CRS will be effective 60 days from publication. Compliance will be required by June 30, 2020.**.**

The IAA has been actively engaged with members and the SEC on all aspects of this landmark rulemaking package. We will continue to work with our members as they seek to understand and implement any new requirements. We will also work with SEC staff on interpretive questions and implementation challenges as they arise.

Most important for our profession, the Commission's new interpretation does not alter the Advisers Act fiduciary duty, which remains strong and robust. There are some wording and placement changes from the proposed interpretation to the final version, but they will have no practical effect on the investment adviser's special relationship of trust and confidence with its clients. As fiduciaries, investment advisers continue to have an affirmative duty of care, loyalty, honesty, and utmost good faith to act in the best interest of their clients. And they will continue to put their clients' interests first.

The IAA held a webinar on the fiduciary duty interpretation on June 27, and a recording is available on our website. We will also hold a webinar on Form CRS on July 19, 2019 at 12:00 pm ET, and have formed a Form CRS Implementation Group to assist members in developing their new form and addressing related issues. If you are interested in joining the group, please contact Sanjay Lamba at sanjay.lamba@investmentadviser.org.

Interpretation on the Advisers Act Fiduciary Duty

The IAA has steadfastly maintained that a new interpretation of the Investment Advisers Act fiduciary duty under Section 206 of the Advisers Act was unnecessary because that duty is widely understood by advisers and established in law, regulation, and professional practice. Nevertheless, we provided substantial comments to the SEC on its proposal to ensure that any formal interpretation accurately reflect the long established understanding

The final interpretation, intended by the Commission to reaffirm, and in some places clarify, that duty reflects many of our comments and reaffirms the special relationship of trust and confidence an adviser has with its clients. It underscores that, as fiduciaries, investment advisers have an overarching duty to act in their clients' best interest, as well as the affirmative duties of care and loyalty. Following the interpretation, investment advisers must continue to make full and fair disclosure of their conflicts of interest, and must also ensure that their conflicts do not compromise their advice. These standards – affirmed by the Commission – have served investors, the capital markets, the economy, and our profession well for decades and will continue to do so. Notably, while the interpretation highlights principles relevant to an adviser's fiduciary duty, it is expressly *not* intended to be the exclusive resource on it, and advisers should continue to think about the principles-based fiduciary duty broadly.

General Statements on the Fiduciary Duty. The final interpretation includes several general statements about the fiduciary duty. As noted above, it emphasizes that an adviser's obligation to act in the best interest of its client is an overarching principle that encompasses both the duty of care and the duty of loyalty. It also stresses that the duty is broad and applies to the entire adviser-client relationship.

Scope of the Relationship and Waivers. In a change from the proposal and responding to commenters' concerns that the proposed interpretation was too retail-focused, the final interpretation includes a discussion recognizing the wide variety of services and clients that advisers have, including institutional clients, and affirming that the fiduciary duty must be viewed in the context of the agreed-upon scope of the relationship. The interpretation makes clear, however, that while an adviser's fiduciary duty may be shaped by agreement, it may not be waived. In a lengthy footnote, the Commission discusses waivers in more detail, including the use of "hedge clauses" – *i.e.*, clauses designed to limit an adviser's liability – in advisory agreements. It notes that whether a hedge clause violates the Advisers Act will depend on the applicable facts and circumstances, including the client's sophistication, and expresses skepticism that a hedge clause could ever be appropriate in an agreement with a retail client. Consistent with earlier statements that the staff will withdraw earlier staff guidance once the Commission has spoken on the issues covered in that guidance, the interpretation withdraws a 2007 no-action letter, known as the *Heitman* Letter, that addressed the staff's views on hedge clauses. The Commission explicitly did not take a view on the scope or substance of any related duty under applicable state law.

Duty of Care*:* As with the proposal, the duty of care section of the final interpretation includes three separate elements: (i) the duty to provide advice that is in the best interest of the client, including a duty to provide advice that is suitable for the client; (ii) the duty to seek best execution; and (iii) the duty to provide advice and monitoring over the course of the relationship.

> *(i) Duty to provide advice in the best interest of the client*. The final interpretation is updated to distinguish between retail and institutional clients. Rather than only refer to a client's "investment profile," which was used in the proposal and is more applicable to retail clients, the final interpretation also discusses client investment objectives. It states that an adviser must have a "reasonable belief that the advice it provides is in the best interest of the client based on the client's objectives. It includes a new discussion on assessing whether high risk and complex products are in a retail client's best interest and the need for daily monitoring of products such as inverse or leveraged exchange-traded products. It also includes more discussion than was in the proposed interpretation about the fact that an adviser's fiduciary duty applies to advice about account types and rollovers.
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> *(ii) Duty to seek best execution*. Similar to the discussion in the proposed interpretation, this section of the interpretation emphasizes that an adviser "must seek to obtain the execution of transactions for each of its clients such that the client's total cost or proceeds in each transaction are the most favorable under the circumstances."
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> *(iii) Duty to provide advice and monitoring over the course of the relationship.* Under the duty of care, an adviser must provide advice and monitoring that is in the best interest of the client, taking into account the scope of the agreed relationship. The Commission expanded this discussion, including by adding that the frequency of monitoring is a material fact about which the adviser must make full and fair disclosure and obtain informed consent from the client, and that advisers may consider whether written policies and procedures regarding monitoring would be appropriate under the Compliance Program Rule.

Duty of Loyalty. The duty of loyalty requires that an adviser not subordinate its clients' interests to its own. "In other words, an investment adviser must not place its own interest ahead of its clients' interests." The proposal had included the additional formulation of this duty that the adviser must put its clients' interests first, but, in response to comments that a literal reading of that language could require advisers to eliminate *all* conflicts, the final interpretation was "revised . . . to be more consistent with how [the SEC has] previously described the duty." However, in a footnote and consistent with the IAA's view, the Commission notes that, "[i]n practice, referring to putting a client's interest first is a plain English formulation commonly used by investment advisers to explain their duty of loyalty in a way that may be more understandable to retail clients." We thus believe that this change from the proposal will have no practical effect and that advisers need not change the way they view or describe their duty of loyalty.

As for the scope of the duty of loyalty, the Commission added to the final interpretation a statement that it applies to all advice an investment adviser provides to its clients, including about investment strategy, engaging a sub-adviser, or account type. The duty of loyalty also requires that advisers make full and fair disclosure to their clients of all material facts relating to the advisory relationship, including disclosure of the capacity in which the firm is acting, which is particularly relevant for dual-registrants.

Regarding conflicts of interest, the interpretation states that advisers must eliminate or make full and fair disclosure of all conflicts of interest which might incline an adviser, consciously or unconsciously, to render advice which is not disinterested, and clients must be able to provide informed consent. Full and fair disclosure and informed consent, however, "do not themselves satisfy the adviser's duty to act in the client's best interest" – the fiduciary duty is overarching. The interpretation also notes that notwithstanding disclosure, advisers "are prohibited from overreaching or taking unfair advantage of an adviser's trust."

For disclosure to be full and fair, "it should be sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision whether to provide consent." This standard does not require advisers "to make an affirmative determination that a particular client understood the disclosure and that the client's consent to the conflict was informed." A client's informed consent can be explicit or, depending on the facts and circumstances, implicit. There may, however, be situations where conflicts may be of a nature or extent that it would be difficult to provide adequate disclosure to clients. In the Commission's view, "where an investment adviser cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent, the adviser should either *eliminate* the conflict or adequately *mitigate (i.e.,* modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible."

The final interpretation, like the proposal, also addresses advisers' use of the word "may," an issue that is at the heart of the SEC's recent Share Class Disclosure Initiative. The interpretation acknowledges, consistent with the IAA's comments, that the word "may" "could be used appropriately to disclose to a client a potential conflict that does not currently exist but might reasonably present itself in the future."

The interpretation also addresses how allocation of investments fits into the duty of loyalty, confirming that advisers and clients may agree that certain investment opportunities or categories of investment opportunities will not be allocated or offered to a client.

***SEC's Request for Comment on Possible Additional Investment Adviser Regulation**:* In the proposed interpretation, the SEC requested comment on whether it should consider three additional areas of investment adviser regulation, specifically relating to financial responsibility requirements, account statements, and licensing and continuing education. In a win for advisers, the Commission did not pursue these areas in its final rulemaking package but rather notes in the interpretation that it is continuing to evaluate related comments. The IAA strongly opposed imposition on advisers of these and other unnecessary and ill-fitting regulations.

Client Relationship Summary – Form CRS

A central element of the rulemaking package is a new relationship summary – Form CRS – that, beginning in July 2020, advisers and broker-dealers will need to provide to retail investors.

Form CRS is intended to be delivered primarily to individuals investing for personal, family, or household purposes. The included disclosures will, among other things, briefly address the types of services being offered and provide information regarding fees, costs, conflicts of interest, and the applicable standard of conduct. As discussed below, delivery of Form CRS will be required at the beginning of the client relationship and be subject to SEC filing and related recordkeeping requirements.

As proposed, Form CRS would have been a standalone, lengthier (four pages) disclosure document using highly prescribed language. Final Form CRS is a shorter (two pages) document that permits more flexibility in how disclosures are written and is more closely integrated with disclosures already provided (e.g., the adviser brochure). Because advisers already provide full and fair disclosure in Form ADV regarding each of the elements required by Form CRS, we did not believe additional disclosure was necessary for advisers. That said, we commend the Commission for incorporating our key recommendations.

Presentation and Format

Many commenters, including the IAA, argued that proposed Form CRS was too dense and difficult to read. The IAA in particular argued that Form CRS should be streamlined and simplified to focus on the key aspects of the relationships and services being offered and should work in tandem with other disclosures already being provided to investors. We especially urged the SEC to leverage the disclosures that investors are already being asked to read by integrating a more streamlined relationship summary with the adviser brochure.

The IAA suggested that there not be any formatting (e.g., paper size, font etc.) requirements and that firms be permitted additional flexibility to convey information to retail investors in a manner that is most likely to be read. Our recommendations also included standardized headings in a question format in order to enhance the ability of retail investors to compare firms in a more meaningful way. The IAA further suggested clearly linking each summary item to additional information on that item in a firm's fuller disclosures to make it easier for investors to find the information they need to compare key information regarding financial service providers. With the assistance of members, we prepared and submitted to the SEC mock-up relationship summaries that integrated each of our recommendations.

Form CRS, as adopted, reflects each of the IAA recommendations discussed above. Specifically, Form CRS utilizes standardized headings in a question format and is significantly more streamlined. Unlike the proposal, the final instructions to Form CRS do not prescribe paper size, font size, and margin width, providing instead that they should be reasonable. And, consistent with the IAA mock-up, the Commission adopted a shorter document (two pages for standalone firms) that relies more heavily on layered disclosure with increased use of hyperlinks and other cross-references to more detailed disclosure.

Disclosure Items

The IAA urged the SEC to carefully consider the disclosure items that should be required in Form CRS noting that while each of the proposed disclosures are useful for investors, some items are more critical than others, and even those that are more critical should be simplified. The final scope of Form CRS attempts to "balance[ ] the need for robust disclosures with the risk of 'information overload' and reader disengagement."

Final Form CRS requires disclosures regarding: (i) the types of client relationships and services being offered; (ii) the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; (iii) whether the firm and its financial professionals currently have reportable legal or disciplinary history; and (iv) how to obtain additional information about the firm.

The Commission made some substantial changes from the proposal. Most notably, it eliminated the proposed comparison section that would have required broker-dealers and investment advisers to include a separate section using prescribed wording in a generalized way to describe how the services of investment advisers and broker-dealers, respectively, differ from the firm's services. Many IAA members were extremely troubled by this aspect of the proposal citing the inappropriateness of requiring firms to include statements about business models other than their own. Consistent with our specific recommendation, Form CRS will not include the proposed comparisons section and instead reference an Investor.gov/CRS page on the SEC's investor education website, which offers educational information to investors about investment advisers, broker-dealers, other financial professionals, and other materials.

Other notable changes include removing the "Key Questions to Ask" section intended to prompt investors to ask certain questions and replacing it with certain "conversation starters" integrated throughout Form CRS. New to Form CRS is a separate section that will require disclosures highlighting how financial professionals are compensated and the conflicts of interest those payments create. This disclosure will distinguish firm-level from financial professional-level conflicts.

Final Form CRS generally broadens the required "types of conflicts" disclosure. Firms will be required to disclose conflicts that were mentioned in the proposal if they exists, including proprietary products, third-party payments (shelf space and revenue sharing arrangements), and principal trading. However, for firms without these conflicts, disclosure will be required about "at least one material conflict." Firms will also be required to include cross-references to more detailed information about the firm's conflicts of interest, a specific recommendation made by the IAA.

Filing, Delivery, and Updating Requirements

For advisers, Form CRS will be required by new Part 3 of Form ADV and will be in addition to the disclosures already required in Parts 1 and 2 of Form ADV. Consistent with the adviser brochure, Form CRS must be delivered to retail investors before or at the time of entering into an investment advisory contract. Registered investment advisers may begin filing their ***initial*** Form CRS on May 1, 2020 and by no later than June 30, 2020. For existing clients, Form CRS will be required to be delivered on an initial one-time basis within 30 days after the date the firm is first required to file. Firms will be required to update Form CRS within 30 days of it becoming materially inaccurate.

Firms will be required to deliver the most recent Form CRS to existing clients when opening new and different accounts, recommending a roll over of assets from retirement accounts, or providing a new advisory service that does not necessitate opening a new account (e.g., first-time purchase of a direct-sold mutual fund or insurance product that is a security through a "check and application" process, *i.e.*, not held directly within an account).

Use of the Word "Fiduciary" and other Interpretive Issues

The final instructions to Form CRS require investment advisers, broker-dealers, and dual-registrants to include a brief statement of the applicable standard of conduct. Firms are required to use the exact language specified in the form's instructions, which does not include the word "fiduciary." According to the adopting release, the final language was modified from the proposal in an effort to use "simplified wording that is short, plain language...but still describes the key components of a broker-dealer's or investment adviser's standard of conduct when providing recommendations or advice." The Commission opted to focus on the term "best interest," and eliminated the word "fiduciary" from the prescribed statement to be provided by advisers.

The IAA sought and received confirmation from senior SEC staff that, indeed, advisers are permitted to use the word "fiduciary" in new Form CRS. Form CRS requires less prescribed wording overall than what was proposed, so firms may generally use their own wording to address required topics and will have more flexibility to provide accurate information to investors. Accordingly, advisers may still use the term "fiduciary" in Form CRS to further elaborate on the duties owed to their clients, for example, when discussing their conflicts of interest.

The IAA will continue to work with our members and SEC staff on additional interpretive and implementation challenges as they arise.

Regulation Best Interest

The primary purpose of the SEC's rulemaking was to raise the standard of conduct for broker-dealers when they recommend securities or investment strategies to retail customers. And indeed, Reg BI, the centerpiece of the package, includes some improved investor protection measures for customers of broker-dealers. The extent to which these measures will in fact protect broker-dealer customers or alleviate the confusion around the capacity of and standard of conduct applicable to a financial professional will depend on how the SEC and FINRA interpret, implement, and enforce this new standard.

Legal Standard of Conduct: The General "Best Interest" Obligation

Under Reg BI, a broker and its associated persons have a "best interest" obligation that applies when they make a recommendation of any securities transaction or investment strategy involving securities ("including account recommendations") to a retail customer. The broker must "act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer."

Scope of Reg BI and General Obligation

The "general obligation" under Reg BI provides that a broker must act in the best interest of a retail customer at the time the recommendation is made, without placing the financial or other interest of the broker ahead of the interests of the retail customer. A retail customer is defined the same as in Form CRS.

Unlike the advisers' fiduciary duty, Reg BI applies to brokers only at a specific moment in time, *i.e.*, at the time the recommendation is made. In the final rule, the standard also applies to recommendations of account types or rollovers. In an important change from the proposal, the standard now applies to implicit recommendations to "hold" as well, provided that the broker has explicitly agreed with a customer to monitor that customer's account. The Reg BI release describes monitoring to include: "monitor[ing] the status and performance of a customer's account" and "ongoing monitoring for purposes of recommending changes in investments."

Elements of the "Best Interest" Obligation

A broker must satisfy all of the following four elements in order to comply with the rule's general obligation. Although the Commission asserts that these specific elements are mandatory and therefore do not function as a safe harbor, if each of these elements is met, the broker will have satisfied its best interest obligation.

(i) *Disclosure Obligation.* Brokers must provide "full and fair" disclosure, before or at the time of the recommendation, of:

- material facts about the scope and terms of the relationship (*e.g.*, any ongoing monitoring) including any material limitations on the recommendations (*e.g., sale only of proprietary products)*, the material fees and costs related to the recommendation, and the relationship between the customer and the broker; and

- material facts about the conflicts of interest associated with the recommendation (*e.g.*, conflicts associated with proprietary products, payments from third parties, and compensation arrangements).

The requirement that disclosure be "full and fair" is stronger than the proposed disclosure requirement, which would have required only "reasonable disclosure."

(ii) *Care Obligation.* Brokers must exercise reasonable diligence, care, and skill in making the recommendation. In a change from the proposal, the Commission added that the recommendation must not place the broker's financial interest ahead of the customer's interest.

(iii) *Conflict of Interest Obligation*. Explicitly recognizing (a) the "particular concerns" raised by conflicts associated with incentives at the associated person level, and (b) the "high-pressure situations" for associated persons raised by incentives such as sales contests and quotas, Reg BI requires brokers to adopt written policies and procedures reasonably designed to:

- Identify and at a minimum disclose, or eliminate, all conflicts of interest, not just material conflicts, associated with the recommendation;
- Identify and mitigate any conflicts of interest associated with the recommendation that create an incentive for an associated person to place his or her or the broker's interest ahead of the retail customer's interest; and
- Eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on sales of specific securities within a limited period of time. The proposal did not require elimination of these types of conflicts.

(iv) *Compliance Obligation*. A new requirement that was not included in the proposal calls for brokers to adopt written policies and procedures reasonably designed to achieve compliance with Reg BI (*e.g.*, to mitigate conflicts of interests that create an incentive for an associated person of the broker to place its interests or the interest of the firm ahead of the retail customer's interest; or to help demonstrate that any "agreed-upon monitoring" is "in connection with and reasonably related to the broker's primary business of effecting securities transactions," so that the broker remains within the solely incidental exclusion from the definition of investment adviser under the Advisers Act, discussed below). This requirement could allow the SEC to bring an enforcement action against a broker-dealer for failure to have adequate policies and procedures even where the broker could argue that it has satisfied the other three elements of the best interest obligation.

Agreed-Upon Monitoring: Permitted Under and Subject to Reg BI

As discussed in our analysis of the solely incidental interpretation, a broker's advice must meet both of the following conditions for it to be excluded from the Advisers Act: (i) it must be solely incidental to brokerage, and (ii) the broker may not receive "special compensation" for the advice. Certain "agreed-upon account monitoring" with the customer where there is no "clearly definable charge for investment advice" may now be considered to be "solely incidental," and when such monitoring occurs, it is subject to Reg BI. In those circumstances, the monitoring of the customer's account and each resulting recommendation to purchase, sell, or hold (an "implicit hold"), is a "recommendation" under Reg BI and subject to the best interest obligation. The adopting release states: "We are interpreting the phrase 'any security transaction or investment strategy' to include instances where there is an agreement to monitor because in this context there is an implicit recommendation to hold at the time the agreed-upon monitoring occurs when the broker-dealer does not provide an express recommendation to buy, sell, or hold." Reg BI applies only at the time the actual monitoring of the account takes place.

Disclosure of Monitoring is Deemed to be an Agreement to Monitor. If a broker "disclos[es] to a customer that the broker dealer will provide monitoring [in Form CRS, that disclosure] constitutes an agreement to monitor."

Voluntary Review without "Definable Charge for Investment Advice": Not Subject to Reg BI. Even though its activities may be deemed to be solely incidental under the new interpretation, a broker will not be subject to Reg BI when it:

- 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.

In these circumstances, Reg BI will apply to any subsequent recommendation but will not apply to an implicit hold recommendation if the broker determines not to act after voluntarily reviewing the account.

Limits on Use of the Terms "Adviser" and "Advisor." Although the SEC did not adopt a separate rule to limit a broker-dealer or its registered representatives from calling themselves an "adviser" or "advisor," Reg BI is intended to effectively prohibit a standalone broker-dealer or a registered representative not acting under the supervision of an investment adviser from calling themselves "adviser" or "advisor." Where a firm is a dually registered IA/BD, and the registered representative is a supervised person of the SEC registered adviser, the firm or representative may use those terms.

Limits on Broker's Misleading Holding Out in Marketing. While the IAA supported the titling limitation, we urged the SEC to go further and address the larger issue of broker marketing communications where a broker and/or its financial professional appears to be holding itself out as an investment adviser. While the final release did not go as far as we requested, it emphasizes that brokers should make sure that they do not hold themselves out in a misleading manner in their marketing materials. Brokers and their financial professionals may state that they provide "advice" in their marketing, but their statements should not contradict disclosures made in Reg BI and Form CRS, and should also be reviewed in light of the solely incidental interpretation. The Commission stated that it will evaluate broker marketing communications to consider whether additional measures may be necessary.

The IAA will also continue monitor market developments and how these provisions are interpreted, implemented, and enforced by the SEC and FINRA over time, as well as whether the provisions in Reg BI truly alleviate, or exacerbate, investor confusion.

Interpretation of "Solely Incidental"

As discussed above, the fourth and final piece of the SEC's rulemaking package is an interpretation addressing an exclusion from the definition of "investment adviser" under the Advisers Act for broker-dealers whose advice is "solely incidental" to the conduct of their business as a broker-dealer and for which they do not receive "special compensation." Release of this interpretation was unexpected since the Commission had not issued a proposed interpretation, although it had requested comment on various aspects of the exclusion in its Reg BI proposal. The Commission decided to issue the interpretation in response to comments that demonstrated disagreement about when the provision of "broker-dealer investment advice" is consistent with the statutory solely incidental prong.

The interpretation reads "solely incidental" extremely broadly, stating 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 is consistent with the solely incidental prong if the advice is provided in connection with and reasonably related to the broker-dealer's primary business of effecting securities transactions." Notably, the Commission adopted the "in connection with and reasonably related to" language notwithstanding a 2011 case that concluded that a broker's advice is solely incidental "*only*" if given "in connection with the primary business of selling securities.

Applying this broad reading of the statute, the Commission provides the following guidance on when a broker-dealer's advice is permitted without that advice coming under the Advisers Act:

(*i) The exercise of unlimited investment discretion is not solely incidental*. Where a broker-dealer is making investment decisions on behalf of customers on an ongoing basis, that activity cannot be solely incidental. Such advice has the "supervisory or managerial character of the investment discretion warranting the protections of the Advisers Act."

(ii) Temporary or limited discretion may be solely incidental. Discretion that 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" may be solely incidental, depending on the totality of the facts and circumstances. Not all temporary or limited discretion, therefore, would be solely incidental. The interpretation includes the following examples of discretionary advice that by themselves would be solely incidental:

(a) Time and price discretion;

(b) Discretion granted on an isolated or infrequent basis when a customer is unavailable for a limited period of time – but in a reversal from a prior SEC position, a period of discretion lasting a few months could be indicative of an advisory relationship;

(c) Discretion as to cash management;

(d) Discretion to buy or sell securities to satisfy margin requirements or other specified customer obligations;

(e) Discretion to buy and sell specific securities to permit a customer to realize a tax loss;

(f) Discretion to buy bonds with a specified rating or maturity; and

(g) Discretion to buy or sell a security or type of security limited by specific customer-established parameters.

(iii) Ongoing monitoring may be solely incidental. In a troubling development, the interpretation concludes that a broker-dealer's agreement "to monitor a retail customer's account on a periodic basis for purposes of providing buy, sell, or hold recommendations" may be solely incidental. The interpretation declines to set forth every circumstance in which ongoing monitoring may be permissible and states that brokers may consider adopting policies and procedures that, if followed, would help them demonstrate that their agree-upon monitoring is solely incidental. The interpretation appears to distinguish between *ongoing* monitoring and *continuous* monitoring. Thus, the only apparent constraint on a broker's ability to monitor a client's account is that it would not be allowed to agree to monitor a customer's 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"* (emphasis added). Reg BI would apply only (a) at the time that the account is monitored under an agreement with the retail customer (b) to any recommendations that result from that monitoring, including an implicit hold recommendation.

(iv) Voluntary review of an account by a broker-dealer in the absence of an agreement is solely incidental. As noted in the Reg BI discussion, this review would not be covered by the Reg BI standard.

The Commission declined to provide guidance on the meaning of "special compensation" but in our view, any compensation received by a broker for provision of limited discretionary advice or ongoing monitoring that is not tied directly to a transaction would risk violating the special compensation prong of the broker-dealer exclusion.

The interpretation notes that the Commission will consider further comment on this interpretation and evaluate whether additional guidance might be appropriate. The IAA is considering providing comment to the SEC questioning whether its expansive reading of the limitation on a broker's permitted activities is consistent with the statute.