SECURITIES AND EXCHANGE COMMISSION

17 CFR Part [~~275~~]276

[Release No. IA-[~~4889~~]5248; File No.

S7-[~~09~~]07-18] RIN: 3235-AM36

[~~Proposed~~]Commission Interpretation Regarding Standard of Conduct for Investment Advisers~~; Request for Comment on Enhancing Investment Adviser Regulation~~ AGENCY: Securities and Exchange Commission.

ACTION: [~~Proposed interpretation; request for comment~~]**Interpretation**.

SUMMARY: The Securities and Exchange Commission (the "SEC" or the "Commission") is publishing [~~for comment a proposed~~]**an** interpretation of the standard of conduct for investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act" or the "Act").[~~The Commission also is requesting comment on: licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC-registered investment advisers, including fidelity bonds.~~]

[~~DATES:~~ ~~Comments should be received on or before August 7, 2018.~~

~~ADDRESSES:~~ ~~Comments may be submitted by any of the following methods:~~

~~Electronic Comments:~~**]**

[~~Use the Commission's Internet comment form (~~][*~~http://www.sec.gov/rules/interp.shtml~~*~~);~~][~~or~~]

[~~Send an e-mail to~~][*~~rule-comments@sec.gov~~*.][~~ Plea~~][~~se include File Number S7-09-18 on~~][~~ the~~]

[~~subject line~~]

EFFECTIVE DATE: [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

[~~Paper Comments:~~]

[~~Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.~~]

[~~All submissions should refer to File Number S7-09-18. This file number should be~~

~~included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (~~][~~*http://www.sec.gov/rules/interp.shtml*~~)~~.]

[~~Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change.~~]

[~~Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.~~]

[~~Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at~~][~~*www.sec.gov*~~][~~to receive notifications by e-mail.~~]

FOR FURTHER INFORMATION CONTACT: **Olawalé Oriola, Senior Counsel; Matthew Cook, Senior Counsel; or** Jennifer Songer, [~~Senior Counsel, or Sara Cortes, Assistant Director~~]**Branch Chief**, at (202) 551-6787 or *IArules@sec.gov*, Investment Adviser Regulation Office, Division of Investment Management, Securities and Exchange Commission, 100 F Street[~~,~~] NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is publishing [~~for comment a~~][~~proposed~~]**an** interpretation of the standard of conduct for investment advisers under the Advisers Act [15 U.S.C. 80b].[1]

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[**I.INTRODUCTION**]

[An investment adviser is a fiduciary, and as such is held to the highest standard of conduct and must act in the best interest of its client.][2][Its fiduciary obligation, which includes an]

[1] 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, and when we refer to rules under the Advisers Act, or any paragraph of these rules, we are referring to title 17, part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

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I. INTRODUCTION

Under federal law, an investment adviser is a fiduciary.[2] The fiduciary duty an investment adviser owes to its client under the Advisers Act, which comprises a duty of care and a duty of loyalty, is important to the Commission's investor protection efforts. Also important to the Commission's investor protection efforts is the standard of conduct that a broker-dealer owes to a retail customer when it makes a recommendation of any securities transaction or investment strategy involving securities.[3] Both investment advisers and broker-dealers play an important

2 *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) ("SEC v. Capital Gains")[. *See*]; *see also infra* [notes][26][32]footnotes 34–44 and accompanying text; Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (July 2, 2004); Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003[) ("Compliance Programs Release"]); Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act

[affirmative duty of utmost good faith and full and fair disclosure of all material facts, is established under federal law and is important to the Commission's investor protection efforts.][3][The Commission also regulates broker-dealers, including the obligations that broker-dealers owe to their customers. Investment advisers and broker-dealers provide

advice and services to retail investors and are important to] our capital markets and our economy more broadly. [Broker-dealers and investment advisers have different types of relationships with their customers and clients and have different models for providing advice, which provide investors with choice about the levels and types of advice they receive and how they pay for the services that they receive.]

[Today, the Commission is proposing a rule that would require all broker-dealers and natural persons who are associated persons of broker-dealers to act in the best interest of retail customers][[4]][when making] a recommendation of any securities transaction or investment strategy involving securities[to retail customers ("Regulation Best Interest").][[5]][We are also proposing to require registered investment advisers and registered broker-dealers to deliver to retail investors a relationship summary, which would provide these investors with information about the relationships and services the firm offers, the standard of conduct and the fees and costs associated with those services, specified conflicts of interest, and whether the firm and its] Release No. 1862 (Apr. 5, 2000). [We acknowledge that investment]**Investment** advisers also have antifraud liability with respect to prospective clients under section 206 of the Advisers Act.

[3] *See* SEC v. Capital Gains, *supra* note][2.][3] ***See*** **Regulation Best Interest, Exchange Act Release No. 34-86031 (June 5, 2019) ("Reg. BI Adoption"). This final interpretation regarding the standard of conduct for investment advisers under the Advisers Act ("Final Interpretation") interprets section 206 of the Advisers Act, which is applicable to both SEC- and state-registered investment advisers, as well as other investment advisers that are exempt from registration**

role in our capital markets and our economy more broadly. **Investment advisers and broker-dealers have different types of relationships with investors, offer different services, and have different compensation models. This variety is important because it presents investors with choices regarding the types of relationships they can have, the services they can receive, and how they can pay for those services.**

On April 18, 2018, the Commission proposed rules and forms intended to enhance the required standard of conduct for broker-dealers[4] and provide retail investors with clear and succinct information regarding the key aspects of their brokerage and advisory relationships.[5] In connection with the publication of these proposals, the Commission

published for comment a separate proposed interpretation regarding the standard of conduct for investment advisers under the Advisers Act ("Proposed Interpretation").[6] We stated in the Proposed Interpretation, and we continue to believe, that it is appropriate and beneficial to address in one release and reaffirm— and in some cases clarify—certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act.[7] After considering the comments received, we are publishing this Final Interpretation with some clarifications to address comments.[8]

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or subject to a prohibition on registration under the Advisers Act. This Final Interpretation is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles. Separately, in various circumstances, case law, statutes (such as the Employee Retirement Income Security Act of 1974 ("ERISA")), and state law impose obligations on investment advisers. In some cases, these standards may differ from the standard enforced by the Commission.

[4 ~~An investment adviser has a fiduciary duty to all of its clients, whether or not the client is a retail investor.~~]4 **Regulation Best Interest, Exchange Act Release No. 83062 (Apr. 18, 2018) ("Reg. BI Proposal").**

5 [~~Regulation Best Interest, Exchange Act Release No. 34-83062 (April~~]**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 (Apr.** 18, 2018) ("[~~Regulation Best Interest~~]**Relationship Summary** Proposal").

[~~financial professionals currently have reportable legal or disciplinary events.~~][6][~~In light of the comprehensive nature of our proposed set of rulemakings, we believe it would be appropriate and beneficial to address in one release~~][7][~~and reaffirm – and in some cases clarify – certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act.~~][8]

[~~An investment adviser's fiduciary duty is similar to, but not the same as, the proposed obligations of broker-dealers under Regulation Best Interest.~~][9][~~While we are not proposing a uniform standard of conduct for broker-dealers and investment advisers in light of their different relationship types and models for providing advice, we continue to consider whether we can improve protection of investors through potential enhancements to the legal obligations of investment advisers. Below, in addition to our interpretation of advisers' existing fiduciary~~

~~obligations, we request comment on three potential enhancements to their legal obligations by considering areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context.~~]

[6] [~~Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles~~]**Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers**; Request for Comment on Enhancing Investment Adviser Regulation, Investment Advisers Act Release No. [~~IA-4888 (April~~]**4889 (Apr.** 18, 2018)[~~("Form CRS Proposal")~~].

[7] [~~This Release~~] ~~is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles.~~[8] ~~The~~]**Further, the** Commission recognizes that many advisers provide impersonal investment advice. *See, e.g.*, Advisers Act rule 203A-3 (defining "impersonal investment advice" in the context of defining "investment

A. Overview of Comments

We received over 150 comment letters on our Proposed Interpretation from individuals, investment advisers, trade or professional organizations, law firms, consumer advocacy groups, and bar associations.[9] Although many commenters generally agreed that the Proposed Interpretation was useful,[10] some noted the challenges inherent in a Commission interpretation covering the broad scope of the fiduciary duty that an investment adviser owes to its clients under the Advisers Act.[11] Some of these commenters suggested modifications to or withdrawal

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adviser representative" as "investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts"). This [~~Release~~]**Final Interpretation** does not address the extent to which the Advisers Act applies to different types of impersonal investment advice.

[8] In the Proposed Interpretation, the Commission also requested comment on: licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC- registered investment advisers, including fidelity bonds. We are continuing to evaluate the comments received in response.

[~~9~~] ~~Regulation Best Interest Proposal, *supra* note~~][~~5.~~][~~ In addition to the obligations proposed in Regulation Best Interest, broker-dealers have a variety of existing specific obligations, including, among others, suitability, best execution, and fair and reasonable compensation. *See, e.g., Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969) ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents that he has an adequate and reasonable basis for the opinions he~~

~~renders."); and FINRA rules 2111 (Suitability), 5310 (Best Execution and Interpositioning), and 2121 (Fair Prices and Commissions)).~~][9] Comment letters submitted in File No. S7-09-18 are available on the Commission's website at https://www.sec.gov/comments/s7-09-18/s70918.htm. We also considered those comments submitted in File No. S7-08-18 (Comments on Relationship Summary Proposal) and File No. S7-07-18 (Comments on Reg. BI Proposal). Those comments are available on the Commission's website at https://www.sec.gov/comments/s7-08-18/s70818.htm and https://www.sec.gov/comments/s7-07- 18/s70718.htm.

[10] *See, e.g.*, Comment Letter of North American Securities Administrators Association (Aug. 23, 2018) ("NASAA Letter") (stating that the Proposed Interpretation is a "useful resource"); Comment Letter of Invesco (Aug. 7, 2018) ("Invesco Letter") (agreeing that "there are benefits to having a clear statement regarding the fiduciary duty that applies to an investment adviser").

[11] *See, e.g.*, Comment Letter of Pickard Djinis and Pisarri LLP (Aug. 7, 2018) ("Pickard Letter") (noting the Commission's "efforts to synthesize case law, legislative history, academic literature, prior Commission releases and other sources to produce a comprehensive explanation of the fiduciary standard of conduct"); Comment Letter of Dechert LLP (Aug. 7, 2018) ("Dechert Letter") ("It is crucial that any universal interpretation of an adviser's fiduciary duty be based on sound and time-tested principles. Given the difficulty of defining and encompassing all of an adviser's responsibilities to its clients, while also accommodating the diversity of advisory arrangements, interpretive issues will arise in the future."); Comment Letter of the Hedge Funds Subcommittee of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association (Aug. 24, 2018) ("ABA Letter") ("We note at the outset that it is difficult to capture the nature of an investment adviser's fiduciary duty in a broad statement that has universal applicability.").

of the Proposed Interpretation.[12] Although most commenters agreed that an investment adviser's fiduciary duty comprises a duty of care and a duty of loyalty, as described in the Proposed Interpretation, they had differing views on aspects of the fiduciary duty and in some cases sought clarification on its application.[13]

Some commenters requested that we adopt rule text instead.[14] The relationship between an investment adviser and its client has long been based on fiduciary principles not generally set forth in specific statute or rule text. We believe that this principles-based approach should continue as it expresses broadly the standard to which investment advisers are held while allowing them flexibility to meet that standard in the context of their specific services. In our view, adopting rule text is not necessary to achieve our goal in this Final Interpretation of reaffirming and in some cases clarifying certain aspects of the fiduciary duty.

[12] *See, e.g.*, Comment Letter of L.A. Schnase (Jul. 30, 2018) (urging the Commission not to issue the Proposed Interpretation in final form, or at least not without substantial rewriting or reshaping); Comment Letter of Money Management Institute (Aug. 7, 2018) ("MMI Letter") (urging the Commission to "revise the interpretation so that it reflects the common law principles in which an investment adviser's fiduciary duty is grounded"); Dechert Letter (recommending that we withdraw the Proposed Interpretation and instead rely on existing authority and sources of law, as well as existing Commission practices for providing interpretive guidance, in order to define the source and scope of an investment adviser's fiduciary duty).

[13] *See, e.g.*, Comment Letter of Cambridge Investment Research Inc. (Aug. 7, 2018) ("Cambridge Letter") (stating that "greater clarity on all aspects of an investment adviser's fiduciary duty will improve the ability to craft such policies and procedures, as well as support the elimination of confusion for retail clients and investment professionals"); Comment Letter of Institutional Limited Partners Association (Aug. 6, 2018) ("ILPA Letter 1") ("Interpretation will provide more certainty regarding the fiduciary duties owed by private fund advisers to their clients."); Comment Letter of New York City Bar Association (Jun. 26, 2018) ("NY City Bar Letter") (stating that the uniform interpretation of an investment adviser's fiduciary duty is necessary).

[14] Some commenters suggested that we codify the Proposed Interpretation. *See, e.g.*, Comment Letter of Roy Tanga (Apr. 25, 2018); Comment Letter of Financial Engines (Aug. 6, 2018) ("Financial Engines Letter"); ILPA Letter 1; Comment Letter of AARP (Aug. 7, 2018) ("AARP Letter"); Comment Letter of Gordon Donohue (Aug. 6, 2018); Comment Letter of Financial Planning Coalition (Aug. 7, 2018) ("FPC Letter").

II. INVESTMENT ADVISERS' FIDUCIARY DUTY

The Advisers Act establishes a federal fiduciary [~~standard~~]**duty** for investment advisers.[~~10~~]**15** This fiduciary [~~standard~~]**duty** is based on equitable common law principles and is fundamental to advisers' relationships with their clients under the Advisers Act.[~~11~~]**16** **The investment adviser's fiduciary duty is broad and applies to the entire adviser-client relationship.**[17] The fiduciary duty to which advisers are subject is not specifically defined in the Advisers Act or in Commission rules, but reflects a Congressional recognition "of the delicate fiduciary nature of an investment advisory relationship" as well as a Congressional intent to "eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser[~~—~~]consciously or unconsciously[~~—~~]to render advice which was not disinterested."[~~12~~]**18** An adviser's fiduciary duty is imposed under the ~~Advisers Act in recognition of the~~[~~nature of the relationship between an investment~~]~~adviser and a client and the desire "so far as is presently practicable to eliminate the abuses" that led to the enactment of the Advisers Act.~~[~~13~~]~~It is made enforceable by the antifraud provisions of the~~

[~~10~~]**15** *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979) ("Transamerica Mortgage v. Lewis") ("§ 206 establishes federal fiduciary standards to govern the conduct of investment advisers.") (quotation marks omitted); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 471, n.11 (1977) (in discussing SEC v. Capital Gains, stating that the Supreme Court's reference to fraud in the "equitable" sense of the term was "premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers"); SEC v. Capital Gains, *supra* [~~note~~]**footnote** 2; Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) ("Investment Advisers Act Release 3060") ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2106 (Jan. 31, 2003) ("Investment Advisers Act Release 2106")).

[~~11~~]**16** *See* SEC v. Capital Gains, *supra* [~~note~~]**footnote** 2 (discussing the history of the Advisers Act, and how equitable principles influenced the common law of fraud and changed the suits brought against a fiduciary, "which Congress recognized the investment adviser to be").

[~~12~~ ~~*See* SEC v. Capital Gains,~~]**17** **The Commission has previously recognized the broad scope of section 206 of the Advisers Act in a variety of contexts. *See, e.g.*, Investment Advisers Act Release 2106,** *supra* [~~note~~]~~2.~~[~~13~~]**footnote 15; Timbervest, LLC, et al., Advisers Act Release No. 4197 (Sept. 17, 2015) (Commission Opinion) (" [O]nce an investment advisory relationship is formed, the Advisers Act does not permit an adviser to exploit that fiduciary relationship by defrauding his client in any investment transaction connected to the advisory relationship."); *see also SEC***

v. *Lauer*, 2008 WL 4372896, at 24 (S.D. Fla. Sept. 24, 2008) ("Unlike the antifraud provisions of the Securities Act and the Exchange Act, Section 206 of the Advisers Act does not require that the activity be 'in the offer or sale of any' security or 'in connection with the purchase or sale of any security.'"); Thomas P. Lemke & Gerald T. Lins, Regulation of Investment Advisers (2013 ed.), at § 2:30 ("[T]he SEC has … applied [sections 206(1) and 206(2)] where fraud arose from an investment advisory relationship, even though the wrongdoing did not specifically involve securities.").

[18] *See* SEC v. Capital Gains, *supra* [~~note~~][~~2~~][(~~"The Advisers Act thus reflects a congressional~~]**footnote 2; *see* *also* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948) ("Arleen Hughes") (Commission Opinion) (discussing the relationship of**

Advisers Act in recognition [~~:~~]of the[~~ delicate fiduciary~~] nature of **the relationship between** an investment [~~advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser — consciously or unconsciously — to render advice which was not disinterested." and also~~]adviser and a client and the desire "so far as is presently practicable to eliminate the abuses" that led to the enactment of the Advisers Act.[19] It is made enforceable by the antifraud provisions of the **Advisers Act.**[20]

An investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty.[21] This fiduciary duty requires an adviser "to adopt the principal's goals,

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trust and confidence between the client and a dual registrant and stating that the registrant was a fiduciary and subject to liability under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act **of 1934).**

[19] ***See* SEC v. Capital Gains, *supra* footnote 2 (**noting that the "declaration of policy" in the original bill, which became the Advisers Act, declared that "the national public interest and the interest of investors are adversely affected**…** when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients. It[~~-[sic]~~] is hereby declared that the policy and purposes of this title, in

[~~Advisers Act.~~][~~14~~]

[~~An investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty. Several commenters responding to Chairman Clayton's June 2017 request for public input~~][~~15~~][~~on the standards of conduct for investment advisers and broker-dealers acknowledged these duties.~~][~~16~~][~~This fiduciary duty requires an adviser "to adopt the principal's goals,~~]~~objectives, or ends."~~[~~17~~]~~This means the adviser must, at all times, serve the best interest of its~~ [~~clients and not subordinate its clients' interest to its own.~~][~~18~~][~~The federal fiduciary duty is~~] accordance with which the provisions of this title shall be interpreted, *are to mitigate and, so far as is presently practicable to eliminate* the abuses enumerated in this section"**)** (citing S. 3580, 76th Cong., 3d Sess., § 202 and Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management,

Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28)**. (emphasis added)**.[*See*] *also* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948) ("Arleen Hughes") ([discussing the relationship of]trust and confidence between the client and a dual registrant and stating that the registrant was a fiduciary and subject to liability under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act[).]

[14 SEC v. Capital Gains, *supra* note][2;][20 ***Id.*;** Transamerica Mortgage v. Lewis, *supra* [note]**footnote** [10]**15** ("[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.").[15 Public Comments from Retail Investors] **Some commenters questioned the standard to which the Advisers Act holds investment advisers. *See, e.g.*, Comment Letter of Stark & Stark, PC (undated) ("The duty of care at common law** and [Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers, Chairman Jay Clayton (June 1, 2017), *available at*][https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31][("Chairman Clayton's Request for Public Input").]**under the Advisers Act only requires that advisers not be negligent in performing their duties.") (internal citation omitted); Comment Letter of Institutional Limited Partners Association (Nov. 21, 2018) ("ILPA Letter 2") ("The Advisers Act standard is a lower simple 'negligence' standard."). Claims arising under Advisers Act section 206(2) are not scienter-based and can be adequately pled with only a showing of negligence. *Robare Group, Ltd., et al. v. SEC*, 922 F.3d 468, 472(D.C. Cir. 2019) ("Robare v. SEC"); *SEC v. Steadman*, 967 F.2d 636, 643, n.5 (D.C. Cir. 1992) (citing SEC v. Capital Gains, *supra* footnote 2) ("[A] violation of § 206(2) of the Investment Advisers Act may rest on a finding of simple negligence."); *SEC v. DiBella*, 587 F.3d 553, 567 (2d Cir. 2009) ("the government need not show intent to make out a section 206(2) violation"); *SEC v. Gruss*, 859 F. Supp. 2d 653, 669 (S.D.N.Y. 2012) ("Claims arising under Section 206(2) are not scienter-based and can be adequately pled with only a showing of negligence."). However, claims arising under Advisers Act section 206(1) require scienter. *See, e.g.*, Robare v. SEC; *SEC v. Moran*, 922 F. Supp. 867, 896 (S.D.N.Y. 1996*); Carroll v. Bear, Stearns & Co.*, 416 F. Supp. 998, 1001 (S.D.N.Y. 1976).**

[16 *See, e.g.*, Comment letter of the Investment Adviser Association (Aug. 31, 2017) ("IAA Letter") ("The well-established fiduciary duty under the Advisers Act, which incorporates both a duty of loyalty and a duty of care, has been applied consistently over the years by courts and the SEC."); Comment letter of the][21 ***See, e.g.*, Investment Advisers Act Release 2106, *supra* footnote 15. These duties were generally recognized by commenters. *See, e.g.*, Comment Letter of** Consumer Federation of America ([Sept. 14, 2017) ("an adviser's fiduciary obligation 'divides neatly into the duty of loyalty and the duty of care.' The duty of loyalty is designed to protect against 'malfeasance,' or wrongdoing, on the part of the adviser, while the duty of care is designed to protect against 'nonfeasance,' such as neglect.").]**Aug. 7, 2018) ("CFA Letter"); Comment Letter of the Investment Adviser Association (Aug. 6, 2018) ("IAA Letter"); Comment Letter of Investments & Wealth Institute (Aug. 6, 2018); Comment Letter of Raymond James (Aug. 7, 2018); FPC Comment Letter. *But see* Dechert Letter (questioning the sufficiency of support for a duty of care).**

objectives, or ends."[22] This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own. In other words, the investment adviser cannot place its own interests ahead of the interests of its client. This combination of care and loyalty obligations has been characterized as requiring the investment adviser to act in the "best interest" of its client at all times.[23] In our view, an investment 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. As discussed in more detail below, in our view, the duty of care requires an investment adviser to provide investment advice in the best interest of its client, based on the client's objectives. Under its duty of loyalty, an investment adviser must eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser— consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict.[24] We believe this is another part of an investment adviser's obligation to act in the best interest of its client.

A. Application of Duty Determined by Scope of Relationship

An adviser's fiduciary duty is imposed under the Advisers Act in recognition of the

[~~17~~]22 Arthur B. Laby, *The Fiduciary Obligations as the Adoption of Ends*, 56 Buffalo Law Review 99 (2008)[~~. See~~]; *see also* Restatement (Third) of Agency, §2.02 Scope of Actual Authority (2006) (describing a fiduciary's authority in terms of the fiduciary's reasonable understanding of the principal's manifestations and objectives).

[~~18~~]23 Investment Advisers Act Release 3060, *supra* footnote [~~10~~]15 (adopting amendments to Form ADV and stating that "under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Investment Advisers Act Release [~~2106~~]2106, *supra* [~~note~~]footnote [~~10~~]15)[~~;~~]. *See SEC v. Tambone*, 550 F.3d 106, 146 (1st Cir. 2008) ("SEC v. Tambone") ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund[~~ and its investors."~~]…"); *SEC v. Moran*, 944 F. Supp. [~~286~~]286, 297 (S.D.N.Y 1996) ("SEC v. Moran") ("Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients."). Although most commenters agreed that an adviser has an obligation to act in its client's best interest, some questioned whether the Proposed Interpretation appropriately considered the best interest obligation as part of the duty of care, or whether it instead should be considered part of the duty of loyalty. *See, e.g.*, MMI Letter; Comment Letter of Investment Company Institute (Aug. 7, 2018) ("ICI Letter").

24 *See infra* footnotes 67-70 and accompanying text for a more detailed discussion of informed consent

and how it is generally considered on an objective basis and may be inferred.

[imposed through the antifraud provisions of the Advisers Act.][19][The duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship through contract when the client receives full and fair disclosure and provides informed consent.][20][Although the ability to tailor the terms means that the application of the fiduciary duty will vary with the terms of the relationship, the relationship in all cases remains that of a fiduciary to a client. In other words,] the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty.[21][We discuss our views][22][on an] nature of the relationship between an adviser and its client—a relationship of trust and confidence.[25] The adviser's fiduciary duty is principles-based and applies to the entire relationship between the adviser and its client. The fiduciary duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship by agreement, provided that there is full and fair disclosure and informed consent.[26] With regard to the scope of the adviser-client relationship, we recognize that investment advisers provide a wide range of services, from a single financial plan for which a client may pay a one- time fee, to ongoing portfolio management for which a client may pay a periodic fee based on the value of assets in the portfolio. Investment advisers also serve a large variety of clients, from retail clients with limited assets and investment knowledge and experience to institutional clients with very large portfolios and substantial knowledge, experience, and analytical resources.[27] In our experience, the principles-based fiduciary duty imposed by the Advisers Act has provided sufficient flexibility to serve as an effective standard of conduct for investment advisers, regardless of the services they provide or the types of clients they serve.

Although all investment advisers owe each of their clients a fiduciary duty under

the Advisers Act, that fiduciary duty must be viewed in the context of the agreed-upon scope of the

[25] ***See, e.g.*, Hearings on S. 3580 before Subcommittee of** the Senate Committee on Banking **and Currency, 76th Cong., 3d Sess. (leading investment advisers emphasized their relationship of "trust and confidence" with their clients); SEC v. Capital Gains, *supra* footnote 2 (citing same).**

[26] **Several commenters asked that we clarify that an adviser and its client can tailor the scope of the relationship to which the fiduciary duty applies through contract. *See, e.g.*, MMI Letter; Financial Engines Letter; ABA Letter.**

[27] **This Final Interpretation also applies** to automated advisers, which are often colloquially referred to as "robo-advisers." **Automated** advisers, like all SEC-registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients. *See* Division of Investment Management, **Robo Advisers, IM Guidance Update No. 2017-02 (Feb. 2017), *available at* https://www.sec.gov/investment/im-guidance-2017-02.pdf (describing Commission staff's guidance as to three distinct areas under the Advisers Act that automated advisers should consider, due to the nature of their business model, in seeking to comply with their obligations under the Advisers Act).**

relationship between the adviser and the client. In particular, the specific obligations that flow from the adviser's fiduciary duty depend upon what functions the adviser, as agent, has agreed to assume for the client, its principal. For example, the obligations of an adviser providing comprehensive, discretionary advice in an ongoing relationship with a retail client (*e.g.*, monitoring and periodically adjusting a portfolio of equity and fixed income investments with limited restrictions on allocation) will be significantly different from the obligations of an adviser to 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 (*e.g.*, a mandate to manage a fixed income portfolio subject to specified parameters, including concentration limits and credit quality and maturity ranges).[28]

While the application of the investment adviser's fiduciary duty will vary with the scope of the relationship, the relationship in all cases remains that of a fiduciary to the client. In other words, an adviser's federal fiduciary duty may not be waived, though it will apply in a manner that reflects the agreed-upon scope of the relationship.[29] A contract provision purporting to waive the adviser's federal fiduciary duty generally, such as (i) a statement that the adviser will not act as a fiduciary, (ii) a blanket waiver of all conflicts of interest, or (iii) a waiver of any

~~[19]~~

28 *See[~~supra note~~]*[~~14.~~]

[~~20~~ ~~*See infra* note~~][~~40~~]~~and accompanying text for a discussion of informed consent~~[~~.~~]**, *e.g.*, *infra* text following footnote 35.**

[~~21~~ ~~As~~][29] **Because** an adviser's federal fiduciary obligations are enforceable through section 206 of the **Advisers** Act, we would view a waiver of enforcement of section 206 as implicating section 215(a) of the **Advisers** Act, which provides that "any condition, stipulation or provision binding any person to waive

compliance with any provision of this title. . . shall be void."[~~ Some commenters on Chairman Clayton's Request for Public Input and other Commission requests for comment also stated that an adviser's fiduciary duty could not be disclosed away. *See, e.g.*, IAA Letter *supra* note ~~][~~16 ~~][~~("While disclosure of conflicts is crucial, it cannot take the place of the overarching duty of loyalty. In other words, an adviser is still first and foremost bound by its duty to act in its client's best interest and disclosure does not relieve an adviser of this duty."); Comment letter of AARP (Sept. 6, 2017) ("Disclosure and consent alone do not meet the fiduciary test."); Financial Planning Coalition Letter (July 5, 2013) responding to SEC Request for Data and Other Information, Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013) ("Financial Planning Coalition 2013 Letter") ("[D]isclosure alone is not sufficient to discharge~~] an investment adviser's fiduciary duty~~[; rather, the key issue is whether the transaction is in the best interest of the client."~~] (internal citations omitted).~~ *See also* Restatement (Third) of Agency, § 8.06 Principal's Consent (2006) ("[~~The~~]**[T]he** law applicable to relationships of agency as defined in [~~§ 1.01 ~~]**§ 1.01** imposes mandatory limits on the circumstances under which an agent may be empowered to take disloyal action. These limits serve protective and cautionary purposes. Thus, an agreement that contains general or broad language purporting to release an agent in advance from the agent's general fiduciary obligation to the principal is not likely to be enforceable. This is because a broadly sweeping release of an agent's fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective, the release would expose the principal to the risk that the agent will exploit the agent's position in ways not foreseeable by the principal at the time the principal agreed to the release. In contrast, when a principal consents to specific transactions or to specified types of conduct by the agent, the principal has a focused opportunity to assess risks that are more readily identifiable.")[~~; Tamar Frankel, Arthur Laby & Ann Schwing, *The Regulation of Money Managers*, (updated 2017) ("The Regulation of Money Managers") ("Disclosure may, but will not always, cure the fraud, since a fiduciary owes a duty to deal fairly with clients.")~~].

specific obligation under the Advisers Act, would be inconsistent with the Advisers Act,[30] regardless of the sophistication of the client.[31]

[30] ***See*** **sections 206 and 215(a). Commenters generally agreed that a client cannot waive** an investment adviser's fiduciary duty **through agreement. *See* Dechert Letter; Comment Letter of Ropes & Gray LLP (Aug. 7, 2018) ("Ropes & Gray Letter"), at n.20; *see also supra* footnote 29. In the Proposed Interpretation, we stated that "**the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty.**" One commenter disputed this broad statement, believing that it called into question "the ability of an investment adviser and client to define the scope of the adviser's services and duties." ABA Letter; *see also* Financial Engines Letter. We have modified this statement to clarify that a general waiver of the fiduciary duty would violate that duty and to provide examples of such a general waiver.**

[~~22~~ ~~In various circumstances, other regulators, including the U.S. Department of Labor, and other legal regimes, including state securities law, impose obligations on investment advisers. In some cases, these standards may differ from the standard imposed and enforced by the Commission.~~]**[31] Some commenters mentioned a 2007 No-Action Letter in which staff indicated that whether a clause in an advisory agreement that purports to limit an adviser's liability under that agreement (a so-called "hedge clause") would violate sections 206(1) and 206(2) of the Advisers Act depends on all of the surrounding facts and circumstances. Heitman Capital Management, LLC, SEC Staff No-Action Letter (Feb. 12, 2007) ("Heitman Letter"). A few commenters indicated that the Heitman Letter expanded the ability of investment advisers to private funds, and potentially other sophisticated clients, to disclaim their fiduciary duties under state law in an advisory agreement. *See, e.g.*, ILPA Letter 1; ILPA Letter 2.**

The commenters' descriptions of the Heitman Letter suggest that it may have been applied incorrectly. The Heitman Letter does not address the scope or substance of an adviser's federal fiduciary duty; rather, it addresses the extent to which hedge clauses may be misleading in violation of the Advisers Act's antifraud provisions. Another commenter agreed with this reading of the Heitman Letter. *See* Comment Letter of American Investment Council (Feb. 25, 2019). In response to these comments, we express below the Commission's views about an adviser's obligations under sections 206(1) and 206(2) of the Advisers Act with respect to the use of hedge clauses. Accordingly, because we are expressing our views in this Final Interpretation, the Heitman Letter is withdrawn.

[~~investment adviser's fiduciary duty in more detail below.~~][~~23~~]

This Final Interpretation makes clear that an adviser's federal fiduciary duty may not be waived, though its application may be shaped by agreement. This Final Interpretation does not take a position on the scope or substance of any fiduciary duty that applies to an adviser under applicable state law. *See supra* footnote 7. The question of whether a hedge clause violates the Advisers Act's antifraud provisions depends on all of the surrounding facts and circumstances, including the particular circumstances of the client (*e.g.*, sophistication). In our view, however, there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with those antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser provided by state or federal law. Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the antifraud provisions, even where the agreement otherwise specifies that the client may continue to retain its non-waivable rights. Whether a hedge clause in an agreement with an institutional client would violate the Advisers Act's antifraud provisions will be determined based on the particular facts and circumstances. To the extent that a hedge clause creates a conflict of interest between an adviser and its client, the adviser must address the conflict as required by its duty of loyalty.

B. Duty of Care

As fiduciaries, investment advisers owe their clients a duty of care.[~~24~~][32] The Commission has discussed the duty of care and its components in a number of contexts.[~~25~~][33] The duty of care includes, among other things: (i) the duty[~~ to act and~~] to provide advice that is in the best interest of the client, (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship.

1. Duty to Provide Advice that is in the [~~Client's~~]Best Interest of the Client

[~~We have addressed an adviser's duty of care in the context of the provision of personalized investment advice. In this context, the~~]The duty of care includes a duty to [~~make a reasonable inquiry into a~~] ~~client's financial situation, level of financial sophistication,~~provide investment advice that is in the best interest of the client, including a duty to provide advice that is suitable for the client.[34] In order to

[~~23~~] ~~The interpretations discussed in this Release also apply~~] ~~to automated advisers, which are often colloquially referred to as "robo advisers." [Robo]advisers, like all SEC registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients[. The staff of the Commission has issued guidance regarding how robo advisers can meet their obligations under the Advisers Act, given the unique challenges and opportunities presented by their business models]. *See Division of Investment Management, [SEC, Staff Guidance on Robo Advisers,* (February 2017), *available at* https://[www.sec.gov/investment/im][guidance-2017-02.pdf.]~~

[~~24~~]32 *See* Investment Advisers Act Release[~~ No.~~] 2106, *supra* [~~note~~]footnote [~~10~~]15 (stating that under the Advisers Act, "an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client[~~'~~]'s behalf, including proxy voting," which is the subject of the release, and citing SEC v. Capital Gains *supra* [~~note~~]footnote 2, to support this point). This Final Interpretation does not address the specifics of how an investment adviser might satisfy its fiduciary duty when voting proxies. *See also* Restatement (Third) of Agency, § 8.08 (discussing the duty of care that an agent owes its principal as a matter of common law); Tamar Frankel & Arthur B. Laby, The Regulation of Money Managers[~~, *supra* note ~~][~~21 ~~] (updated 2017) ("Advice can be divided into three stages. The first determines the needs of the particular client.
The second determines the portfolio strategy that would lead to meeting the client's needs. The third relates to the choice of securities that the portfolio would contain. The duty of care relates to each of the stages and depends on the depth or extent of the advisers' obligation towards their clients.").

[~~25~~]33 *See, e.g.*, Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Release No. 1406 (Mar. 16, 1994) ("Investment

Advisers Act Release 1406") (stating that advisers have a duty of care and discussing advisers' suitability obligations); **Interpretive Release Concerning the Scope of Section 28(e) of the** Securities[~~; Brokerage and Research Services~~] **Exchange Act of 1934 and Related Matters**, Exchange Act Release No. 23170 (Apr. [~~23,~~]**28,** 1986) ("Exchange Act Release 23170") ("an adviser, as a fiduciary, owes its clients a duty of obtaining the best execution on securities transactions[~~.~~]"). We highlight certain contexts**, but not all,** in which the Commission has addressed the duty of care[~~ but we note that there are others; for example, voting proxies when an adviser undertakes to do so~~]. ***See, e.g.,*** Investment Advisers Act Release 2106, *supra* [~~note~~]**footnote** [~~10.~~]**15.**

[~~experience, and investment objectives~~] ~~(which we refer to collectively as the~~ [~~client's "investment profile") and a duty to provide personalized advice that is suitable for and in the best interest of the client based on the client's investment profile.~~][~~26~~]

[~~An adviser must, before providing any personalized investment advice and as appropriate thereafter, make a reasonable inquiry into the client's investment profile. The nature and extent of the inquiry turn on what is reasonable under the circumstances, including the nature and extent of the agreed-upon advisory services,~~] ~~the nature and complexity of the anticipated investment advice~~[~~, and the investment profile of the client. For example,~~] ~~to formulate a comprehensive financial plan for a~~ [~~client, an adviser might obtain a range of personal and financial information about the client, including~~] ~~current income, investments, assets and debts, marital status, insurance policies, and financial goals.~~[~~27~~]

[~~An adviser must update a client's investment profile in order to adjust its advice to reflect any changed circumstances.~~][~~28~~][~~The frequency with which the adviser must update the information in order to consider changes to any advice the adviser provides would turn on many factors~~]~~, including whether the adviser is aware of events that have occurred that could render inaccurate or incomplete the investment profile on which~~ [~~it~~] ~~currently bases its advice. For~~

[~~26~~]**34** In 1994, the Commission proposed a rule that would [~~make~~]**have made** express the fiduciary obligation of investment advisers to make only suitable recommendations to a client. Investment Advisers Act Release 1406, *supra* [~~note~~]**footnote** [~~25.~~]**33.** Although never adopted, the rule was designed, among other things, to reflect the Commission's interpretation of an adviser's *existing* suitability obligation under the Advisers Act. **In addition, we do not cite Investment Advisers Act Release 1406 as the source of authority for the view we express here, which at least one comment letter suggested, but cite it merely to show that the Commission has long held this view. *See* Comment Letter of the Managed Funds Association and the Alternative Investment Management Association (Aug. 7, 2018) (indicating that the Commission's failure to adopt the proposed suitability rule means "investment advisers are not subject to an express 'suitability' standard**

provide such advice, an adviser must have a reasonable understanding of the client's

objectives. The basis for such a reasonable understanding generally would include, for retail clients, an understanding of the investment profile, or for institutional clients, an understanding of the investment mandate.[35] The duty to provide advice that is in the best interest of the client based on a reasonable understanding of the client's objectives is a critical component of the duty of care.

Reasonable Inquiry into Client's Objectives

How an adviser develops a reasonable understanding will vary based on the specific facts and circumstances, including the nature of the client, the scope of the adviser-client relationship, and the nature and complexity of the anticipated investment advice**.**

In order to develop a reasonable understanding of a retail client's objectives, an adviser should, at a minimum, make a reasonable inquiry into the client's financial situation, level of financial sophistication, **investment experience, and financial goals** (which we refer to collectively as the **retail client's "investment profile"). For example, an adviser undertaking** to formulate a comprehensive financial plan for a **retail client would generally need to obtain a**

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under existing regulation"). We believe that this obligation[~~, when combined with~~] **to make only suitable recommendations to a client is part of** an adviser's fiduciary duty to act in the best interest of its client**. Accordingly**, [~~requires~~]an adviser [~~to~~]**must** provide investment advice that is suitable for /~~*and in the best interest of* its client~~/**its client in providing advice that is in the best interest of its client. *See* SEC v. Tambone, *supra* footnote 23 ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund…."); SEC v. Moran, *supra* footnote 23 ("Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients.")**.

[35] **Several commenters stated that the duty to make a reasonable inquiry into a client's investment profile may not apply in the institutional client context. *See, e.g.*, Comment Letter of BlackRock, Inc. (Aug. 7, 2018); Comment Letter of Teachers Insurance and Annuity Association of America (Aug. 7, 2018); Comment Letter of Allianz Global Investors U.S. LLC (Aug. 7, 2018) ("Allianz Letter"); Comment Letter of John Hancock Life Insurance Company (U.S.A.) (Aug. 3, 2018). Accordingly, we are describing the duty as a duty to have a reasonable understanding of the client's objectives. While not every client will have an investment profile, every client will have objectives. For example, an institutional client's objectives may be ascertained through its investment mandate.**

range of personal and financial information about the client such as current income, investments, assets and debts, marital status, **tax status,** insurance policies, and financial goals.[36]

In addition, it will generally be necessary for an adviser to a retail client to update the client's investment profile in order to maintain a reasonable understanding of the client's objectives and adjust the advice to reflect any changed circumstances.[37] The frequency with which the adviser must update the client's investment profile in order to consider changes to any advice the adviser provides would itself turn on the facts and circumstances, including whether the adviser is aware of events that have occurred that could render inaccurate or incomplete the investment profile on which **the adviser** currently bases its advice. For **instance, in the case of a financial plan where the investment adviser also provides advice on an ongoing basis**, a change in the relevant tax law or knowledge that the client has retired or experienced a change in marital status **could** trigger an obligation to make a new **inquiry.**

By contrast, in providing investment advice to institutional clients, the nature and extent of the reasonable inquiry into the client's objectives generally is shaped by the specific investment mandates from those clients. For example, an investment adviser engaged to advise on an institutional client's investment grade bond portfolio would need to gain a reasonable understanding of the client's objectives within that bond portfolio, but not the client's objectives

[~~27~~]36 Investment Advisers Act Release 1406, *supra* [~~note~~]**footnote** [~~25.~~]**33.** After making a reasonable inquiry into the client's investment profile, it generally would be reasonable for an adviser to rely on information provided by the client (or the client's agent) regarding the client's financial circumstances, and an adviser should not be held to have given advice not in its client's best interest if it is later shown that the client had misled the adviser **concerning the information on which the advice was based**.

[~~28~~ ~~We note that this would not be done for a one-time financial plan or other investment advice that is not provided on an ongoing basis. *See also infra* note ~~][~~37.~~][~~example~~], ~~a change in the relevant tax law or knowledge that the client has retired or experienced a change in marital status~~ [~~might~~]

~~trigger an obligation to make a new~~[~~inquiry.~~][37] **Such updating would not be needed with one-time investment advice. In the Proposed Interpretation, we stated that an adviser "must" update a client's investment profile in order to adjust the advice to reflect any changed circumstances. We believe that any obligation to update a client's investment profile, like the nature and extent of the reasonable inquiry into a retail client's objectives, turns on what is reasonable under the circumstances. Accordingly, we have revised the wording of this statement in this Final Interpretation.**

within its entire investment portfolio. Similarly, an investment adviser whose client is a registered investment company or a private fund would need to have a reasonable understanding of the fund's investment guidelines and objectives. For advisers acting on specific investment mandates for institutional clients, particularly funds, we believe that the obligation to update the client's objectives would not be applicable except as may be set forth in the advisory agreement.

Reasonable belief that advice is in the best interest of the client

An investment adviser must [~~also~~]have a reasonable belief that the [~~personalized~~]advice **it provides** is [~~suitable for and~~]in the best interest of the client based on the client's [~~investment profile. A~~]**objectives. The formation of a** reasonable belief would involve considering, for example, whether investments are recommended only to those clients who can and are willing to tolerate the risks of those investments and for whom the potential benefits may justify the risks.[~~29~~][38] Whether the advice is in a client's best interest must be evaluated in the context of the portfolio that the adviser manages for the client and the client's [~~investment profile.~~]**objectives.**

For example, when an adviser is advising a **retail** client with a conservative investment objective, investing in certain derivatives may be in the client's best interest when they are used to hedge interest rate risk **or other risks** in the client's portfolio, whereas investing in certain directionally speculative derivatives on their own may not. For that same client, investing in a particular security on margin may not be in the client's best interest, even if investing in that same security **without the use of margin** may be in the client's best interest. [~~When~~] ~~advising a financially sophisticated~~ [~~investor with a high risk tolerance, however, it may be consistent with the adviser's duties to recommend investing in such directionally speculative derivatives or investing in securities on margin.~~]**However, for**

[~~The cost (including fees and compensation) associated with investment advice would~~

~~generally be one of many important factors—such as the~~] ~~investment product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks~~

[~~29~~ ~~We note that~~][38] Item 8 of Part 2A of Form ADV requires an investment adviser to describe its methods of analysis and investment strategies and disclose that investing in securities involves risk of loss which clients should be prepared to bear. This item also requires that an adviser explain the material risks involved for each significant investment strategy or method of analysis it uses and particular type of security it recommends, with more detail if those risks are significant or unusual. **Accordingly, investment advisers are required to identify and explain certain risks involved in their investment strategies and the types of securities they recommend. An investment adviser needs to consider those same risks in determining the clients to which the adviser recommends those investments.**

example, when advising a financially sophisticated client, such as a fund or other sophisticated client that has an appropriate risk tolerance, it may be in the best interest of the client to invest in such derivatives or in securities on margin, or to invest in other complex instruments or other products that may have limited liquidity.

Similarly, when an adviser is assessing whether high risk products—such as penny stocks or other thinly-traded securities—are in a retail client's best interest, the adviser should generally apply heightened scrutiny to whether such investments fall within the retail client's risk tolerance and objectives. As another example, complex products such as inverse or leveraged exchange- traded products that are designed primarily as short-term trading tools for sophisticated investors may not be in the best interest of a retail client absent an identified, short-term, client-specific trading objective and, to the extent that such products are in the best interest of a retail client initially, they would require daily monitoring by the adviser.[39]

A reasonable belief that investment advice is in the best interest of a client also requires that an adviser conduct a reasonable investigation into the investment sufficient not to base its advice on materially inaccurate or incomplete information.[40] We have taken enforcement action where an investment adviser did not independently or reasonably investigate securities before recommending them to clients.[41]

[39] *See* Exchange-Traded Funds, Securities Act Release No. 10515 (June 28, 2018); SEC staff and FINRA, Investor Alert, Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors (Aug. 1, 2009); SEC Office of Investor Education and Advocacy, Investor Bulletin: Exchange- Traded Funds (ETFs) (Aug. 2012); *see also* FINRA Regulatory Notice 09-31, Non-Traditional ETFs – FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds (June 2009).

[40] *See, e.g.*, Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) (indicating that a fiduciary "has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information").

[41] *See, e.g.*, In the Matter of Larry C. Grossman, Investment Advisers Act Release No. 4543 (Sept. 30, 2016) (Commission Opinion) ("*In re* Grossman") (in connection with imposing liability on a principal of a

The cost (including fees and compensation) associated with investment advice would generally be one of many important factors—such as an investment product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility[~~and~~]**,** likely performance in a variety of market and economic conditions**, time horizon, and cost of exit**—to consider when determining whether a security or investment strategy involving a security or securities is in the best interest of the client. [~~Accordingly~~]**When considering similar investment products or strategies**, the fiduciary duty does not necessarily require an adviser to recommend the lowest cost investment product or strategy.[~~We believe that an adviser could not reasonably believe that a recommended security is~~] ~~in the best interest of~~ [~~a client if it is higher cost than a security that is otherwise identical, including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance. For example, if an adviser advises its clients to invest in a mutual fund share class that is more expensive than other available options when the adviser is receiving compensation that creates a potential conflict and that may reduce the client's return, the adviser may violate its fiduciary duty and~~] ~~the antifraud provisions~~ [~~of the Advisers Act if it does not, at a minimum, provide full and fair disclosure of the conflict and its impact on the client and obtain informed client consent to the conflict.~~][~~30~~][~~Furthermore~~]

Moreover, an adviser would not satisfy its fiduciary duty to provide advice that is in the client's best interest by simply advising its client to invest in the [~~least expensive~~]**lowest cost (to the client)** or least remunerative **(to the investment adviser)** investment product or strategy without any further analysis of other factors in the context of the portfolio that the adviser manages for the client and the client's [~~investment profile~~]**objective. Rather, the adviser could recommend a higher-cost investment or strategy if the adviser reasonably concludes that there are other factors about the investment or strategy that outweigh cost and make the**

investment or strategy in the best interest of the client, in light of that client's objectives. For example, it might be consistent with an adviser's fiduciary duty to advise a client with a high risk tolerance and significant investment experience to invest in a private equity fund with relatively [high fees if other factors about the fund, such as its diversification and potential performance benefits, cause it to be in the client's best interest. We believe that a] reasonable belief that investment advice is in the best interest of a client also**higher fees and significantly less liquidity as compared with a fund that invests in publicly-traded companies if the private equity fund was in the client's best**

[30 *See infra* notes 48 – 52 and accompanying text (discussing an adviser's duties related to disclosure and consent).]

registered investment adviser for recommending offshore private investment funds to clients)**,** ***stayed in part,*** **Investment Advisers Act No. 4563 (Nov. 1, 2016),** ***response to remand,*** **Investment Advisers Act Release No. 4871 (Mar. 29, 2018) (reinstating the Sept. 30, 2016 opinion and order, except with respect to the disgorgement and prejudgment interest in light of the Supreme Court's decision in** ***Kokesh v. SEC,*** **137 S. Ct. 1635 (2017)).**

interest because it provided exposure to an asset class that was appropriate in the context of the client's overall portfolio.

requires that an adviser conduct a reasonable investigation into the investment sufficient [to not] base its advice on materially inaccurate or incomplete information.[31] We have[brought enforcement actions] where an investment adviser did not independently or reasonably investigate securities before recommending them to clients.[32]][This obligation to provide advice that is suitable and in the best interest applies not just to potential investments, but]**An adviser's fiduciary duty applies** to all **investment** advice the investment adviser provides to clients, including advice about [an]investment strategy[or]**,** engaging a sub-adviser[and advice about whether to rollover a retirement account so that the investment adviser manages that account.]**, and account type.[42] Advice about account type includes advice about whether to**

open or invest through a certain type of account (*e.g.*, a commission-based brokerage account or a fee-based advisory account) and advice about whether to roll over assets from one account (*e.g.*, a retirement account) into a new or existing account that the adviser or an affiliate of the adviser manages.[43] In providing advice about account type, an adviser should consider all types of accounts offered by the adviser and acknowledge to a client when the account types the adviser offers are not in the client's best interest.[44]

[42] **In addition, with respect to prospective clients, investment advisers have antifraud liability under section 206 of the Advisers Act, which, among other things, applies to transactions, practices, or courses of business which operate as a fraud or deceit upon prospective clients, including those regarding investment strategy, engaging a sub-adviser, and account type. We believe that, in order to avoid liability under this antifraud provision, an investment adviser should have sufficient information about the prospective client and its objectives to form a reasonable basis for advice before providing any advice about these matters. At the point in time at which the prospective client becomes a client of the investment adviser (*e.g.*, at account opening), the fiduciary duty applies. Accordingly, while advice to prospective clients about these matters must comply with** the antifraud provisions **under section 206 of the Advisers Act, the adviser must also satisfy its fiduciary duty with respect to any such advice (*e.g.*, regarding account type) when a prospective client becomes a client.**

[43] **We consider advice about "rollovers" to include advice about account type, in addition to any advice regarding the investments or investment strategy with respect to the assets to be rolled over, as the advice necessarily includes the advice about the account type into which assets are to be rolled over. As noted below, as a general matter, an adviser's duty to monitor extends to all personalized advice it provides to the client, including, for example, in an ongoing relationship, an evaluation of whether a client's account or program type (for example, a wrap account) continues to be in the client's best interest. *See infra* text accompanying footnote 52.**

[44] **Accordingly, in providing advice to a client or customer about account type, a financial professional who is dually licensed (*i.e.*, an associated person of a broker-dealer and a supervised person of an investment adviser (regardless of whether the professional works for a dual registrant, affiliated firms, or unaffiliated firms)) should consider all types of accounts offered (*i.e.*, both brokerage accounts and advisory accounts) when determining whether the advice is in the client's best interest. A financial professional who is only a supervised person of an investment adviser (regardless of whether that advisory firm is a dual registrant or affiliated with a broker-dealer) may only recommend an advisory account the adviser offers when the account is in the client's best interest. If a financial professional who is only a supervised person of an**

2. Duty to Seek Best Execution

[~~We have addressed an~~]**An** investment adviser's duty of care [~~in the context of trade~~]**includes a** duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades (typically in the case of discretionary accounts)[~~. We have said that, in this context, an adviser has the~~] ~~duty to seek best~~[~~ execution~~] ~~of a client's transactions~~.[~~33~~][45] In meeting this obligation, 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. An adviser fulfills this duty by [executing]**seeking to obtain the execution of** securities transactions on behalf of a client with the goal of

[31] *See, e.g.*, Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) ([stating "as a fiduciary, the proxy advisory firm]has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information").

[32] *See*] In the Matter of Larry C. Grossman, Investment Advisers Act Release No. 4543 (Sept. 30, 2016) (Commission [opinion) ([]imposing liability on a principal of a registered investment adviser for recommending offshore private investment funds to clients[without a reasonable independent basis for his advice).]

[33] *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006) (stating that investment advisers have "best execution obligations"); Investment Advisers Act Release 3060, *supra* [note][10](discussing an adviser's best execution obligations in the context of directed brokerage arrangements and disclosure of soft dollar practices)[. *See*] *also* Advisers Act rule 206(3)-2(c) (referring to adviser's duty of best execution of client transactions). maximizing value for the client under the particular circumstances occurring at the time of the transaction. [As noted below, maximizing]**Maximizing** value [can encompass]**encompasses** more than just minimizing cost.

When seeking best execution, an adviser should consider "the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness" to the adviser.[34-]**46** In other words, the **"**determinative factor**"** is not the lowest possible commission cost **, "**but whether the transaction represents the best qualitative execution.**"47** Further, an

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investment adviser chooses to advise a client to consider a non-advisory account (or to speak with other personnel at a dual registrant or affiliate about a non-advisory account), that advice should be in the best interest of the client. This same framework applies in the case of a prospective client, but any advice or recommendation given to a prospective client would be subject to the antifraud provisions of the federal securities laws. *See supra* footnote 42 and Reg. BI Adoption, *supra* footnote 3.

45 *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006) (stating that investment advisers have "best execution obligations"); Investment Advisers Act Release 3060, *supra* **footnote 15** (discussing an adviser's best execution obligations in the context of directed brokerage arrangements and disclosure of

soft dollar practices)**; *see* *also*** Advisers Act rule 206(3)-2(c) (referring to adviser's duty of best execution of client transactions).

[46] Exchange Act Release 23170, *supra* **footnote 33.**

[47] ***Id.***

investment adviser should "periodically and systematically" evaluate the execution it is receiving for clients.[~~35~~]**[**[48]

3. Duty[~~ to Act and~~] to Provide Advice and Monitoring over the Course of the Relationship

An investment adviser's duty of care also encompasses the duty to provide advice and monitoring [~~over the course of a~~]**at a frequency that is in the best interest of the client, taking into account the scope of the agreed relationship.[49] For example, when the adviser has an ongoing** relationship with a client[~~.~~][~~[36]~~][~~An adviser is required to provide advice and services to a client over the course of the relationship at a frequency that is both in the~~] **and is compensated with a periodic asset-based fee, the adviser's duty to provide advice and monitoring will be relatively extensive as is consistent with the nature of the relationship.[50] Conversely, absent an express agreement regarding the adviser's monitoring obligation, when the adviser and the client have a relationship of limited duration, such as for the provision of a**

[~~34~~] ~~Exchange Act Release 23170, *supra* [note][25.]~~

[~~35~~]48 *Id*. The Advisers Act does not prohibit advisers from using an affiliated broker to execute client trades. However, the adviser's use of such an affiliate involves a conflict of interest that must be fully and fairly disclosed and the client must provide informed consent to the conflict.[~~36~~ ~~*See*~~] ***See also* Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1732 (Jul. 17, 1998) (discussing application of section 206(3) of the Advisers Act to certain principal and agency transactions). Two commenters requested that we prescribe specific obligations related to best execution. Comment Letter of the Healthy Markets Association (Aug. 7, 2018); Comment Letter of ICE Data Services (Aug. 7, 2018). However, prescribing specific requirements of how an adviser might satisfy its best execution obligations is outside of the scope of this Final Interpretation.**

49 ***Cf.*** SEC v. Capital Gains, *supra* [~~note~~]**footnote** 2 (describing advisers' "basic function" as "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments" (quoting Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28)). *Cf.* Barbara Black, *Brokers and Advisers-What's in a Name?*, 32 Fordham Journal of Corporate and Financial Law XI (2005) ("[W]here the investment adviser's duties include management of the account, [the adviser] is under an obligation to monitor the performance of the account and to make appropriate changes in the portfolio."); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 Villanova Law Review [~~701, at 728~~]**701** (2010) ("Laby Villanova Article") (stating that the scope of an adviser's activity can be altered by contract and that an adviser's fiduciary duty **would be commensurate with the scope of the relationship**) (internal citations omitted).

[50] However, an adviser and client may scope the frequency of the adviser's monitoring (*e.g.*, agreement to monitor quarterly or monthly and as appropriate in between based on market events), provided that there is full and fair disclosure and informed consent. We consider the frequency of monitoring, as well as any other material facts relating to the agreed frequency, such as whether there will also be interim monitoring when there are market events relevant to the client's portfolio, to be a material fact relating to the advisory relationship about which an adviser must make full and fair disclosure and obtain informed consent as required by its fiduciary duty.

one-time financial plan for a one-time fee, the adviser is unlikely to have a duty to monitor. In other words, in the absence of any agreed limitation or expansion, the scope of the duty to monitor will be indicated by the duration and nature of the agreed advisory arrangement.[51] As a general matter, an adviser's duty to monitor extends to all personalized advice it provides to the client, including, for example, in an ongoing relationship, an evaluation of whether a client's account or program type (for example, a wrap account) continues to be in the client's best interest.[52]

C. Duty of Loyalty

The duty of loyalty requires that an adviser not subordinate its clients' interests to its own.[53] In other words, an investment adviser must not place its own interest ahead of its client's interests.[54] To meet its duty of loyalty, an adviser must make full and fair disclosure to its clients

[51] ***See also*** Laby Villanova Article, *supra* **footnote 49, at 728 (2010)**) ("If an adviser has agreed to provide continuous supervisory services, the scope of the adviser's fiduciary duty entails a continuous, ongoing duty to supervise the client's account, regardless of whether any trading occurs. This feature of the adviser's duty, even in a non-discretionary account, contrasts sharply with the duty of a broker administering a non-discretionary account, where no duty to monitor is required.") (internal citations omitted).

[~~best interest of the client and consistent with the scope of advisory services agreed upon between the investment adviser and the client. The duty to provide advice and monitoring is particularly important for an adviser that has an ongoing relationship with a client (for example, a relationship where the adviser is compensated with a periodic asset-based fee or an adviser with discretionary authority over client assets). Conversely, the steps needed to fulfill this duty may be relatively circumscribed for the adviser and client that have agreed to a relationship of limited duration via contract (for example, a financial planning relationship where the adviser is compensated with a fixed, one-time fee commensurate with the discrete, limited-duration nature of the advice provided).~~][[37]~~][~~An adviser's duty to monitor extends to all personalized advice it provides the client, including an evaluation of whether a client's account or program type (for example, a wrap account) continues to

~~be in the client's best interest.~~]

[~~B.~~]~~Duty of Loyalty~~The duty of loyalty requires [~~an investment adviser to put its client's interests first. An investment adviser must not favor its own interests over those of a client or unfairly favor one client over another.~~][~~38~~][~~In seeking to meet its duty of loyalty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship.~~][~~39~~][~~In addition, an~~][~~37~~ ~~*See*~~ ~~Laby Villanova Article, *supra* [note][36,][at 728 (2010]) (stating that the scope of an adviser's activity can be altered by contract and that an adviser's fiduciary duty[would be commensurate with the scope of the relationship).~~]**[52] Investment advisers also may consider whether written policies and procedures relating to monitoring would be appropriate under Advisers Act rule 206(4)-7, which requires any investment adviser registered or required to be registered under the Advisers Act to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons.**

[53] Investment Advisers Act Release 3060, *supra* footnote 15 (adopting amendments to Form ADV and stating that "[u]nder the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Investment Advisers Act Release 2106, *supra* footnote 15). The duty of loyalty applies not just to advice regarding potential investments, but to all advice the investment adviser provides to an existing client, including advice about investment strategy, engaging a sub-adviser, and account type. *See supra* text accompanying footnotes 42-43.

[54] For example, an adviser cannot favor its own interests over those of a client, whether by favoring its own accounts or by favoring certain client accounts that pay higher fee rates to the adviser over other client accounts. **The Commission has brought numerous enforcement actions against advisers that** allocated trades to their own accounts and allocated less favorable or unprofitable trades to their clients' accounts. *See, e.g.*, *SEC v. Strategic Capital Management, LLC and Michael J. Breton*, Litigation Release No. 23867 (June 23, 2017) (partial settlement) (adviser placed trades through a master brokerage account and then allocated profitable trades to adviser's account while placing unprofitable trades into the client accounts **in**

of all material facts relating to the advisory relationship.[55] Material facts relating to the advisory relationship include the capacity in which the firm is acting with respect to the advice provided. This will be particularly relevant for firms or individuals that are dually registered as broker- dealers and investment advisers and who serve the same client in both an advisory and a brokerage capacity. Thus, such firms and individuals generally should provide full and fair disclosure about the circumstances in which they intend to act in their brokerage capacity and the circumstances in which they intend to act in their advisory capacity. This disclosure may be accomplished through a variety of means, including, among others, written disclosure at the beginning of a relationship that clearly sets forth when the dual registrant would act in an advisory capacity and how it would provide notification of any changes in capacity.[56] Similarly, a dual registrant acting in its advisory capacity should disclose any circumstances under which its advice will be limited to a menu of certain products offered through its affiliated broker- dealer or affiliated investment adviser.

[~~38~~] **violation of fiduciary duty and contrary to disclosures). In the Proposed Interpretation, we stated that the duty of loyalty requires an adviser to "put its client's interest first." One commenter suggested that the requirement of an adviser to put its client's interest "first" is very different from a requirement not to "subordinate" or "subrogate" clients' interests, and is inconsistent with how the duty of loyalty had been applied in the past. *See* Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association (Aug. 7, 2018) ("SIFMA AMG Letter"). Accordingly, we have revised the description of the duty of loyalty in this Final Interpretation to be more consistent with how we have previously described the duty.** *See* Investment Advisers Act Release [~~3060~~]**3060, *supra* footnote 15** ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own[~~,~~]**.**")**(**citing Investment Advisers Act Release [~~2106~~]**2106,** *supra* [~~note~~]**footnote** [~~9~~]**15**). **In 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.**

55 *See [~~also~~]* ~~Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection[Act]* (Jan. 2011), *available at* https://[www.sec.gov/news/studies/2011/913studyfinal.pdf][("913 Study").]~~[39] ~~Investment Advisers Act Release 3060, *supra* [note 6]~~**SEC v. Capital Gains, *supra* footnote 2 ("Failure to disclose material facts must be deemed fraud or deceit within its intended meaning."); Investment Advisers Act Release 3060, *supra* footnote 15** ("as a fiduciary, an

adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship")[~~. *See*~~]**; *see* *also*** General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship.").

[56] *See also* Reg. BI Adoption, *supra* footnote 3, at 99.

In addition, an adviser must eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.[57] We believe that while full and fair disclosure of all material facts relating to the advisory relationship or of conflicts of interest and a client's informed consent prevent the presence of those material facts or conflicts themselves from violating the adviser's fiduciary duty, such disclosure and consent do not themselves satisfy the adviser's duty to act in the client's best interest.[58] To illustrate what

[~~adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship. The disclosure~~] ~~should be sufficiently specific so that a client is able to~~ [~~decide whether to provide informed consent to the conflict of interest.~~][~~[40]~~][~~We discuss each of these aspects of the duty of loyalty below.~~][~~Because an adviser must serve the best interests of its clients, it has an obligation not to subordinate its clients' interests to its own.~~]~~For example, an adviser cannot favor its own interests over those of a client, whether by favoring its own accounts or by favoring certain client accounts that pay higher fee rates to the adviser over other client accounts.~~[~~[41]~~][~~Accordingly, the duty of loyalty includes a duty not to treat some clients favorably at the expense of other clients. Thus, we believe that in allocating investment opportunities among eligible clients, an adviser~~]**[57] In the Proposed Interpretation, we stated that an adviser must seek to avoid conflicts of interest with its clients. Proposed Interpretation, *supra* footnote 6. Some commenters requested clarity on what it means to "seek to avoid" conflicts of interest. *See, e.g.*, Comment Letter of Schulte Roth & Zabel LLP (Aug. 8, 2018); ABA Letter (stating that this wording could be read to require an adviser to first seek to avoid a conflict, before addressing a conflict through disclosure, rather than being able to provide full and fair disclosure of a conflict, and only seek avoidance if the conflict cannot be addressed through disclosure). The Commission first used this phrasing when adopting amendments to the Form ADV Part 2 instructions. *See* Investment Advisers Act Release 3060, *supra* footnote 15 and General Instruction 3 to Part 2 of Form ADV ("As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship."). The release adopting this instruction clarifies the Commission's intent that it capture the fiduciary duty described in SEC v. Capital Gains and Arleen Hughes. *See* Investment Advisers Act Release 3060, *supra* footnote 15, at n.4 and accompanying text (citing SEC v. Capital Gains, *supra* footnote 2, and Arleen Hughes, *supra* footnote 18, as the basis of this language). Both of these cases emphasized that the adviser, as a fiduciary, should seek to avoid conflicts, but at a minimum must make full and fair disclosure of the conflict and obtain the client's informed consent. *See* SEC v. Capital Gains, *supra* footnote 2 ("The**

Advisers Act thus reflects . . . a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."); Arleen Hughes, *supra* footnote 18 ("Since loyalty to his trust is the first duty which a fiduciary owes to his principal, it is the general rule that a fiduciary must not put himself into a position where his own interests may come in conflict with those of his principal" but if a fiduciary "chooses to assume a role in which she is motivated by conflicting interests, . . . she may do so if, but only if, she obtains her client's consent after disclosure . . ."). We believe the Commission's reference to "seek to avoid" conflicts in the Form ADV Part 2 instructions is consistent with the Final Interpretation's statement that an adviser "must eliminate or at least expose all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested" as well as the substantively identical statements in SEC v. Capital Gains, *supra* footnote 2, and Arleen Hughes, *supra* footnote 17. While an adviser may satisfy its duty of loyalty by making full and fair disclosure of conflicts of interest and obtaining the client's informed consent, an adviser is prohibited from overreaching or taking unfair advantage of a client's trust.

[58] **As noted above, an investment 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. *See* SEC v. Tambone, *supra* footnote 23 (stating that Advisers Act section 206 "imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund . . . and *includes* an obligation to provide 'full and fair disclosure of all material facts'") (emphasis added) (citing SEC v. Capital Gains, *supra* footnote 2). We describe**

constitutes full and fair disclosure, we are providing the following guidance on (i) the appropriate level of specificity, including the appropriateness of stating that an adviser "may" have a conflict, and (ii) considerations for disclosure regarding conflicts related to the allocation of investment opportunities among eligible clients.

In order 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.[59] For example, it would be inadequate to disclose that the adviser has "other clients" without describing how the adviser will manage conflicts between clients if and when they arise, or to disclose that the adviser has "conflicts" without further description.**

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above in this Final Interpretation how the application of an investment adviser's fiduciary duty to its client will vary with the scope of the advisory relationship. *See supra* section II.A.

[~~40~~]**59** Arleen Hughes, *supra* [~~note~~]**footnote** [~~13,~~]**18,** at 4 and 8 (stating, "[s]ince loyalty to his trust is the first duty which a fiduciary owes to his principal, it is the general rule that a fiduciary must not put himself into a position where his own interests may come in conflict with those of his principal. To prevent any conflict and

the possible subordination of this duty to act solely for the benefit of his principal, a fiduciary at common law is forbidden to deal as an adverse party with his principal. An exception is made, however, where the principal gives his informed consent to such dealings," and adding that, "[r]egistrant has an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent.")[~~. *See*~~]**; *see*** *also Hughes v. Securities and Exchange Commission*, 174 F.2d 969 (1949) (affirming the SEC decision in Arleen Hughes)[~~.~~]/~~*See also*~~/**;** General Instruction 3 to Part 2 of Form ADV (stating that an adviser's disclosure obligation "requires that [the adviser] provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest [the adviser has] and the business practices in which [the adviser] engage[s], and can give informed consent to such conflicts or practices or reject them"); Investment Advisers Act Release 3060, *supra* [~~note~~]**footnote** [~~10~~][~~(same);~~]**15;** Restatement (Third) of Agency §8.06 ("Conduct by an agent that would otherwise constitute a breach of duty as stated in §§ 8.01, 8.02, 8.03, 8.04, and 8.05 [referencing the fiduciary duty] does not constitute a breach of duty if the principal consents to the conduct, provided that (a) in obtaining the principal's consent, the agent (i) acts in good faith, (ii) discloses all material facts that the agent knows, has reason to know, or should know would reasonably affect the principal's judgment unless the principal has manifested that such facts are already known by the principal or that the principal does not wish to know them, and (iii) otherwise deals fairly with the principal; and (b) the principal's consent concerns either a specific act or transaction, or acts or transactions of a specified type that could reasonably be expected to occur in the ordinary course of the agency relationship**.**")**. *See infra* footnotes 67-70 and accompanying text for a more detailed discussion of informed consent and how it is generally considered on an objective basis and may be inferred.**

[~~41~~] ~~The Commission has brought numerous enforcement actions~~ [~~against advisers that unfairly~~] ~~allocated trades to their own accounts and allocated less favorable or unprofitable trades to their clients' accounts. *See, e.g., SEC v. Strategic Capital Management, LLC and Michael J. Breton*, Litigation Release No. 23867 (June 23, 2017) (partial settlement) (adviser placed trades through a master brokerage account and then allocated profitable trades to adviser's account while placing unprofitable trades into the client accounts~~[~~.~~**).**]

[~~must treat all clients fairly.~~][~~42~~][~~This does not mean that an adviser must have a *pro rata* allocation policy, that the adviser's allocation policies cannot reflect the differences in clients' objectives or investment profiles, or that the adviser cannot exercise judgment in allocating investment opportunities among eligible clients. Rather, it means that an adviser's allocation policies must be fair and, if they present a conflict, the adviser must fully and fairly disclose the conflict~~]~~such that a client can provide informed consent~~[~~.~~][~~An adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure to its clients of all material conflicts of interest that could affect the advisory relationship.~~][~~43~~][~~Disclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers~~]**Similarly, disclosure that an adviser "may" have a particular conflict, without more, is not adequate when the conflict actually exists.[60] For example, we would consider the use of "may" inappropriate when the conflict exists with respect to some (but not all) types or classes of clients, advice, or transactions without additional disclosure specifying the types or classes of clients, advice, or transactions with respect to which the conflict exists. In addition, the use of "may" would be inappropriate if it simply precedes a list of all possible or potential conflicts regardless of likelihood and obfuscates actual conflicts to the point that a client cannot provide informed consent. On the other hand, the word "may" could be appropriately used to disclose to a client a potential conflict that does not currently exist but might reasonably present itself in the future.[61]**

Whether the disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the material fact or conflict. Full and fair disclosure for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity

and more resources than

[60] We have brought enforcement actions in such cases. *See, e.g.*, **In the Matter of The Robare Group, Ltd., et al.,** Investment Advisers Act Release No. 4566 (Nov. 7, 2016) (Commission Opinion) (**finding, among other things, that adviser's disclosure that it *may* receive a certain type of compensation was inadequate because it did not reveal that the adviser actually had an arrangement pursuant to which it received fees that presented a potential conflict of interest); *aff'd in part and rev'd in part on other grounds Robare* v. SEC, *supra* footnote 20; *In re Grossman*, *supra* footnote 41 (indicating that "the use of the prospective 'may' in [the relevant Form ADV disclosures] is misleading because it suggested the mere possibility that [the broker] would make a referral and/or be paid 'referral fees' at a later point, when in fact a commission- sharing arrangement was already in place and generating income"). *Cf. Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 640 (D.C. Cir. 2008) ("The Commission noted the critical distinction between disclosing the risk that a future event *might* occur and disclosing actual knowledge the event *will* occur.") (emphasis in original). For Form ADV Part 2 purposes, advisers are instructed that when they have a conflict or engage in a practice with respect to some (but not all) types or classes of clients, advice, or transactions, to indicate as such rather than disclosing that they "may" have the conflict or engage in the practice. General Instruction 2 to Part 2 of Form ADV.**

[61] **We have added this example of a circumstance where "may" could be appropriately used in response to the request of some commenters. *See, e.g.*, Pickard Letter; ICI Letter; Ropes & Gray Letter; IAA Letter.**

retail clients to analyze and understand complex conflicts and their ramifications.[62] Nevertheless, regardless of the nature of the client, the disclosure must be clear and detailed enough for the client to make an informed decision to consent to the conflict of interest or reject it.

When allocating investment opportunities among eligible clients, an adviser may face conflicts of interest either between its own interests and those of a client or among different clients.[63] If so, the adviser must eliminate or at least expose through full and fair disclosure the conflicts associated with its allocation policies, including how the adviser will allocate investment opportunities, such that a client can provide informed consent.[64] When allocating investment opportunities, an adviser is permitted to consider the nature and objectives of the client and the scope of the relationship.[65] An adviser need not have *pro rata* allocation policies, or any particular method of allocation, but, as with other conflicts and material facts, the

[62] ***Arleen Hughes, supra*** **footnote 18 (the "method and extent of disclosure depends upon the particular client involved," and an unsophisticated client may require "a more extensive explanation than the informed investor").**

[63] ***See*** **Restatement (Third) of Agency, § 8.01 General Fiduciary Principle (2006) ("Unless the principal consents, the general fiduciary principle, as elaborated by the more specific duties of loyalty stated in §§ 8.02 to 8.05, also requires that an agent refrain from using the agent's position or the principal's property to benefit the agent or a third party.").**

[64] The Commission has brought numerous enforcement actions **alleging that advisers unfairly allocated client trades to preferred clients without making full and fair disclosure.** ***See*** Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*[-][~~[44]~~-][~~Any disclosure must be clear and detailed enough for a client to make a reasonably informed decision to consent to such conflicts and practices or reject them~~] (Jan. 2011), *available at* https://**www.sec.gov/news/studies/2011/913studyfinal.pdf, at 23–24 (citing enforcement actions). This Final Interpretation sets forth the Commission's views regarding what constitutes full and fair disclosure**.[~~[45]~~-][~~An adviser must provide the client with sufficiently specific facts so that the client is able to understand the adviser's conflicts of interest and~~][~~[42]~~] *See***, e.g., *supra* text accompanying footnote 59;** ***see*** *also* Barry Barbash and Jai Massari, *The Investment Advisers Act of 1940; Regulation by Accretion*, 39 Rutgers Law Journal 627 (2008) (stating that under section 206 of the Advisers Act and traditional notions of fiduciary and agency law**,** an adviser must not give

preferential treatment to some clients or systematically exclude eligible clients from participating in specific opportunities without providing the clients with appropriate disclosure regarding the treatment).

[43] ~~*See* SEC v. Capital Gains, *supra* note][2][(advisers must fully disclose all material conflicts, citing Congressional intent "to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested"). *See also* Investment Advisers Act Release 3060, *supra* note][9.]~~[65] **An adviser and a client may even agree that certain investment opportunities or categories of investment opportunities will not be allocated or offered to a client.**

adviser's allocation practices must not prevent it from providing advice that is in the best interest of its clients.[66]

[44 ~~*See* SEC v. Capital Gains, *supra* note ~~][~~2~~][~~(in discussing the legislative history of the Advisers Act, citing ethical standards of one of the leading investment counsel associations, which provided that an investment counsel should remain "as free as humanly possible from the subtle influence of prejudice, conscious or unconscious" and "avoid any affiliation, or any act which subjects his position to challenge in this respect" and stating that one of the policy purposes of the Advisers Act is "to mitigate and, so far as is presently practicable to eliminate the abuses" that formed the basis of the Advisers Act). Separate and apart from potential liability under the antifraud provisions of the Advisers Act enforceable by the Commission for breaches of~~]**While most commenters agreed that informed consent is a component of the** fiduciary duty**, a few commenters objected to what they saw as subjectivity** in the [~~absence~~]**use** of **the term "informed" to describe a client's consent to a disclosed conflict.[67] The fact that disclosure must be** full and fair [~~disclosure, investment advisers may also wish to consider their potential liability to clients under state common law, which may vary from state to state.~~][45 ~~*See* Arlene Hughes, *supra* at ~~][~~13~~][~~(in finding that registrant had not obtained~~]such that a client can provide informed consent **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 of interest was informed. Rather, disclosure should be designed to put a client in a position to be able to understand and provide** informed consent[~~, citing to testimony indicating that "some clients had no understanding at all of the nature and significance" of the disclosure).~~][~~business practices well enough to make an informed decision.~~][46 ~~-~~][~~For example, an adviser disclosing that it "may" have a conflict is not adequate disclosure when the conflict actually exists.~~][47 ~~-~~] **to the conflict of interest.** A client's informed consent can be either explicit or, depending on the facts and circumstances, implicit. **68** We believe, however, that it would not be consistent with an adviser's fiduciary duty to infer or accept client consent[~~ to a conflict~~] where [~~either (i) the facts and circumstances indicate~~]**the adviser was aware, or reasonably should have been aware,** that

the client did not understand the nature and import of the conflict[~~, or~~][~~(ii)the material facts concerning the conflict could not be fully and fairly disclosed.~~][~~48~~][~~For example, in some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure that adequately conveys the material facts or the nature, magnitude and potential effect of the conflict necessary to obtain informed consent and satisfy an adviser's fiduciary duty. In other cases, disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive. With some complex or~~][~~46~~ ~~*See* General Instruction 3 to Part 2 of Form ADV. *Cf.* Arleen Hughes, *supra* note~~][~~13~~][~~(Hughes acted simultaneously in the dual capacity of investment adviser and of broker and dealer and conceded having a fiduciary duty. In describing the fiduciary duty and her potential liability under the antifraud provisions of the Securities Act and the Exchange Act, the Commission stated she had "an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent.").~~]**.**[**69**]

66 **In the Proposed Interpretation, we stated that "in allocating investment opportunities among eligible clients, an adviser must treat all clients fairly." Some commenters interpreted this statement to mean that it would be impermissible for an adviser to allocate a particular investment to one eligible client instead of a second eligible client, even when the second client had received full and fair disclosure and provided informed consent to such an investment being allocated to the first client. *See, e.g.*, Ropes & Gray Letter; SIFMA AMG Letter. We have removed that sentence from this Final Interpretation and replaced it with this discussion that clarifies our views regarding allocation of investment opportunities.**

67 ***See, e.g.*, Comment Letter of LPL Financial LLC (Aug. 7, 2018); Ropes & Gray Letter.**

68 **We do not interpret an adviser's fiduciary duty to require that full and fair disclosure or informed consent be achieved in a written advisory contract or otherwise in writing. For example, an adviser could provide a client full and fair disclosure of all material facts relating to the advisory relationship as well as full and fair disclosure of all conflicts of interest which might incline the adviser, consciously or unconsciously, to render advice that was not disinterested, through a combination of Form ADV and other disclosure and the client could implicitly consent by entering into or continuing the investment advisory relationship with the adviser.**

[~~47~~] ~~We have brought enforcement actions in such cases. *See, e.g.*,~~ [~~In the Matter of The Robare Group, Ltd., et~~] [~~al.,~~]~~Investment Advisers Act Release No. 4566 (Nov. 7, 2016) (Commission Opinion)~~ ([~~appeal docketed) (finding, among other things, that adviser's disclosure was inadequate because it stated that the adviser *may* receive compensation from a broker as a result of the facilitation of transactions on client's behalf through such broker-dealer and that these arrangements *may* create a conflict of interest when adviser *was*, in fact, receiving payments from the broker and *had* such a conflict of interest).~~]

[~~48~~]**69** *See* Arleen Hughes, *supra* [~~note~~]**footnote** [~~13~~]**18** ("Registrant cannot satisfy this duty by executing an agreement with her clients which the record shows some clients do not understand and which, in any event, does not contain the essential facts which she must communicate.")[~~Some commenters on Commission requests for comment agreed that full and fair disclosure and informed consent are important components of~~

~~an adviser's fiduciary duty. *See, e.g.*, Financial Planning Coalition 2013 Letter, *supra* note ~~][~~21~~][~~("[C]onsent is only informed if the customer has the ability fully to understand and to evaluate the information. Many complex products … are appropriate only for sophisticated and experienced investors. It is not sufficient for a fiduciary to make disclosure of potential conflicts of interest with respect to such products. The fiduciary must make a reasonable judgment that the customer is fully able to understand and to evaluate the product and the potential conflicts of interest that it presents—and then the fiduciary must make a judgment that the product is in the best interests of the customer.").~~]**. In the Proposed Interpretation, we stated that inferring or accepting client consent to a conflict would not be consistent with the fiduciary duty where "the material facts concerning the conflict could not be fully and fairly disclosed." Some commenters expressed**

In some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure to clients that adequately conveys the material facts or the nature, magnitude, and potential effect of the conflict sufficient for a client to consent to or reject it.[70] In other cases, disclosure may not be specific enough for a client to understand whether and how the conflict could affect the advice it receives. For retail clients in particular, it may be difficult to provide disclosure regarding complex or extensive conflicts[~~, it may be difficult to provide disclosure~~] that is sufficiently specific, but also understandable[~~, to the adviser's clients~~]. In all of these cases where [~~full and fair disclosure and~~]**an investment adviser cannot fully and fairly disclose a conflict of interest to a client such that the client can provide** informed consent[~~is insufficient, we expect an~~]**, the** adviser [~~to~~]**should either** *eliminate* the conflict or adequately *mitigate* **(*i.e.*, modify practices to reduce)** the conflict [~~so that it can be more readily disclosed~~]**such that full and fair disclosure and informed consent are possible**.

Full and fair disclosure of all material facts [~~that could affect an~~]**relating to the** advisory relationship, [~~including~~]**and** all [~~material~~]conflicts of interest [~~between the adviser and the client~~]**which might incline an investment adviser—consciously or unconsciously— to render advice which was not disinterested**, can help clients and prospective clients in evaluating and selecting investment advisers. Accordingly, we require advisers to deliver to their clients a "brochure," under Part 2A of Form ADV, which sets out minimum disclosure requirements, including disclosure of certain conflicts.[~~49~~][71] Investment advisers are required to ~~deliver the brochure to a prospective client at or before entering into a contract so that the prospective client can use the information contained in the brochure to decide whether or not to enter into the advisory relationship.~~[~~50~~]~~In a concurrent release, we are~~ [~~proposing to require all investment advisers to deliver to retail investors before or at~~] ~~the time the adviser enters into an investment advisory~~

agreement [~~a relationship summary which would include a summary of certain conflicts of interest.~~][~~51~~]**with this statement. *See, e.g.*, CFA Letter (agreeing that "advisers should be precluded from inferring or accepting client consent to a conflict" where the material facts concerning the conflict could not be fully and fairly disclosed). Other commenters expressed doubt that such disclosure could be impossible. *See, e.g.*, Allianz Letter ("[W]e have not encountered a situation in which we could not fully and fairly disclose the material facts, including the nature, extent, magnitude and potential effects of the conflict."). In response to commenters, we have replaced the general statement about an inability to fully and fairly disclose material facts about the conflict with more specific examples of how advisers can make such full and fair disclosure. *See supra* text accompanying footnotes 59-66.**

70 **As discussed above, institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications. *See supra* text accompanying footnote 62.**

[~~49~~]71 Investment Advisers Act Release 3060, *supra* [~~note~~]**footnote** [~~10;~~]**15:** General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of

deliver the brochure to a prospective client at or before entering into a contract so that the prospective client can use the information contained in the brochure to decide whether or not to enter into the advisory relationship.**72** In a concurrent release, we are **requiring all investment advisers to deliver to retail investors, at or before** the time the adviser enters into an investment advisory **agreement, a relationship summary, which would include, among other things, a plain English summary of certain of the firm's conflicts of interest, and would encourage retail investors to inquire about those conflicts.73**

III. ECONOMIC CONSIDERATIONS

As noted above, this Final Interpretation is intended to reaffirm, and in some cases clarify, certain aspects of an investment adviser's fiduciary duty under the Advisers Act. The Final Interpretation does not itself create any new legal obligations for advisers. Nonetheless, the Commission recognizes that to the extent an adviser's practices are not consistent with the Final Interpretation provided above, the Final Interpretation could have potential economic effects. We discuss these potential effects below.

interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship. This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of

interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them."). ***See also*** **Robare v. SEC, *supra* footnote 20 ("[R]egardless of what Form ADV requires, [investment advisers have] a fiduciary duty to fully and fairly reveal conflicts of interest to their clients.").**

[~~50~~]**72** Investment Advisers Act rule 204-3. ***See*** Investment Advisers Act Release 3060, *supra* [~~note~~][~~10~~]**footnote 15** (adopting amendments to Form ADV and stating that**,** "A client may use this disclosure to select his or her own adviser and evaluate the adviser's business practices and conflicts on an ongoing basis. As a result, the disclosure clients and prospective clients receive is critical to their ability to make an informed decision about whether to engage an adviser and, having engaged the adviser, to manage that relationship.").

~~[51 Form CRS Proposal, *supra* note]~~**[~~6.~~]**

[~~C.~~][~~Request for Comment~~]

[~~The Commission requests comment on our proposed interpretation regarding certain aspects of the fiduciary duty under section 206 of the Advisers Act.~~]

[~~·Does the Commission's proposed interpretation offer sufficient guidance with respect to the fiduciary duty under section 206 of the Advisers Act?~~**][**~~·Are there any significant issues related to an adviser's fiduciary duty that the proposed interpretation has not addressed?~~**]**

[~~·Would it be beneficial for investors, advisers or broker-dealers for the Commission to codify any portion of our proposed interpretation of the fiduciary duty under section 206 of the Advisers Act?~~**]**

[~~III. ECONOMIC CONSIDERATIONS~~][~~The Commission is sensitive to the potential economic effects of the proposed interpretation provided above.~~][~~52~~][~~In this section we discuss how the proposed Commission interpretation may benefit investors and reduce agency problems by reaffirming and clarifying the fiduciary duty an investment adviser owes to its clients. We also discuss some potential broader economic effects on the market for investment advice.~~] **To the extent that the information required for inclusion in the brochure does not satisfy an adviser's disclosure obligation, the adviser "may have to disclose to clients information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require" and this disclosure may be made "in [the] brochure or by some other means." General Instruction 3 to Part 2 of Form ADV.**

73 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. 5247 (June 5, 2019) ("Relationship Summary Adoption").

A. Background

The Commission's interpretation of the standard of conduct for investment advisers under the Advisers Act set forth in this [~~Release~~]**Final Interpretation** would affect investment advisers

and their associated persons as well as the clients of those investment advisers, and the market for

[~~[52] The Commission, where possible, has sought to quantify the economic impacts expected to result from the proposed interpretations. However, as discussed more specifically below, the Commission is unable to quantify certain of the economic effects because it lacks information necessary to provide reasonable estimates.~~] financial advice more broadly.[~~[53]~~][~~There are 12,659~~]**[74] As of December 31, 2018, there were 13,299** investment advisers registered with the Commission with over $[~~72~~]**84** trillion in assets under management as well as [~~17,635~~]**17,268** investment advisers registered with states [~~and 3,587~~]**with approximately $334 billion in assets under management and 3,911** investment advisers who submit Form ADV as exempt reporting advisers.[~~[54]~~][**75**] As of December [~~2017,~~]**31, 2018,** there are approximately [~~36~~]**41** million client accounts advised by SEC-registered investment advisers.[**76**]

These investment advisers currently incur ongoing costs related to their compliance with their legal and regulatory obligations, including costs related to[~~their~~] understanding[~~of~~] the standard of conduct. We believe, based on the Commission's experience, that the interpretations [~~we are setting~~]**set** forth in this [~~Release~~]**Final Interpretation** are generally consistent with investment advisers' current understanding of [~~the practices necessary to comply with~~]their fiduciary duty under the Advisers Act[~~; however~~]**.[77] However**, we recognize that **as the scope of the**

[74] ***See*** **Relationship Summary Proposal, *supra* footnote 5, at section** IV.A (discussing the market for financial advice generally).

[75] **Data on investment advisers is based on staff analysis of Form ADV, particularly Item 5.F.(2)(c) of Part 1A for Regulatory Assets under Management. Because this Final Interpretation interprets an adviser's fiduciary duty** under section 206 of the Advisers Act, this interpretation would be applicable to both SEC- and state-registered investment advisers, as well as other investment advisers that are exempt from registration or subject to a prohibition on registration under the Advisers Act.

[76] **Item 5.F.(2)(f) of Part 1A of Form ADV.**

[77] *See supra* section II.B.i. For example, some commenters asked that we clarify from the Proposed Interpretation that an adviser and its client can tailor the scope of the relationship to which the fiduciary duty applies, through contract. *See, e.g.*, MMI Letter; Financial Engines Letter; ABA Letter. *See supra* footnotes 67–69 and accompanying text, including clarifications addressing these commenters' concerns. More generally, some commenters requested clarifications from the Proposed Interpretation, and we are issuing this Final Interpretation to address those issues raised by commenters, as discussed in more detail above.

adviser-client relationship varies and in many cases can be broad, there may be certain current circumstances where investment advisers [~~who have interpreted~~]interpret their fiduciary duty to require something less, [~~or~~]and other current circumstances where they interpret their fiduciary duty to require something more, than ~~the Commission's interpretation~~this Final Interpretation. We lack data to identify which investment advisers currently understand [~~the practices necessary to comply with~~]their fiduciary duty to [~~be~~]require something different from the standard of conduct [~~in the Commission's interpretation~~]articulated in this Final Interpretation. Based on our experience over decades of interacting with the investment management industry as its primary regulator, however, we generally believe that it is not a significant portion of the market.

One commenter suggested that the Proposed Interpretation's discussion of how an adviser fulfills its fiduciary duty appeared to be based in the context of having as a client an individual investor, and not a fund.[78] This commenter indicated its concerns about the ability of a fund manager to infer consent from a client that is a fund, and that issues regarding inferring consent from funds could significantly increase compliance costs for venture capital funds.[79]

Our discussion above in this Final Interpretation includes clarifications to address comments, and expressly acknowledges that while all investment advisers owe each of their clients a fiduciary duty, the specific application of the investment adviser's fiduciary duty must be viewed in the context of the agreed-upon scope of the adviser-client relationship.[80] This Final Interpretation, as compared to the Proposed Interpretation, includes significantly

more examples of the application of the fiduciary duty to institutional clients, and clarifies the Commission's interpretation **of what constitutes full and fair disclosure and informed consent, acknowledging a number of comments**

[78] ***See*** **Comment Letter of National Venture Capital Association (Aug. 7, 2018) ("NVCA Letter").**

[79] ***Id.***

[80] ***See supra*** **section II.A.**

on this topic.[81] We believe that these clarifications will help address some of this commenter's concerns with respect to increased compliance costs for venture capital funds, in part by clarifying how the fiduciary duty can apply to institutional clients. We continue to believe, based on our experience with investment advisers to different types of clients, that advisers understand their fiduciary duty to be generally consistent with the standards of this Final Interpretation.

B. Potential Economic [~~Impacts~~]Effects

Based on our experience as the long-standing regulator of the investment adviser industry, the Commission's interpretation of the fiduciary duty under section 206 of the Advisers

[53] ~~*See* Form CRS Proposal, *supra* note][6,][at Section] IV.A (discussing the market for financial advice generally).~~

[54] ~~*See* Form CRS Proposal, *supra* note][6,][at Section IV.A.1.b (discussing SEC-registered investment advisers). Note, however, that because we are interpreting advisers' fiduciary duties] under section 206 of the Advisers Act, this interpretation would be applicable to both SEC- and state-registered investment advisers, as well as other investment advisers that are exempt from registration or subject to a prohibition on registration under the Advisers Act.~~

Act described in this [~~Release~~]Final Interpretation generally reaffirms the current practices of investment advisers. Therefore, we expect there to be no significant economic [~~impacts from the interpretation. We do acknowledge, however~~]effects from this Final Interpretation. However, 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 investment advisers currently understand the practices necessary to comply with their fiduciary duty to be different from those discussed in this [~~interpretation~~]Final Interpretation, there could be some[~~potential~~] economic effects, which we discuss below.

Clients of investment advisers

The typical relationship between an investment adviser and a client is a principal-agent relationship, where the principal (the client) hires an agent (the investment adviser) to perform

[81] **In particular, this Final Interpretation expressly notes our belief that a client generally may provide its informed consent implicitly "by entering into or continuing the investment advisory relationship with the adviser" after disclosure of a conflict of interest. *See supra* footnote 68.**

some service (investment advisory services) on the [~~client~~]**principal**'s behalf.[~~55~~]**82** Because investors and investment advisers are likely to have different preferences and goals, the investment adviser relationship is subject to agency problems**, including those resulting from conflicts**: that is, investment advisers may take actions that increase their well-being at the expense of investors, thereby imposing agency costs on investors.[~~56~~]**83** A fiduciary duty, such as the duty investment advisers owe their clients, can mitigate these agency problems and reduce agency costs by deterring [~~agents~~]**investment advisers** from taking actions that expose them to legal liability.[~~57~~]**84**

To the extent [~~the Commission's interpretation of investment adviser fiduciary duty would cause~~]**this Final Interpretation causes** a change in behavior of those investment advisers, if any, who currently interpret their fiduciary duty to require something different from [~~the Commission's interpretation~~]**this Final Interpretation**, we expect a potential reduction in agency problems and, consequently, a reduction of agency costs to the client.**85 For example, an adviser that, as part of its duty of loyalty, fully and fairly discloses86 a conflict of interest and receives informed consent from its client with respect to the conflict may reduce agency costs by increasing the client's awareness of the conflict and improving the client's ability to monitor the adviser with respect to this conflict. Alternatively, the client may choose to not consent given the information the adviser**

[~~55~~]**82** *See*, *e.g.*, James A. Brickley, Clifford W. Smith, Jr.[~~,~~] **&** Jerold L. Zimmerman, *Managerial Economics and Organizational Architecture* (2004), at 265 ("An agency relationship consists of an agreement under which one party, the principal, engages another party, the agent, to perform some service on the principal's behalf.")[~~. *See*~~]**; *see** also* Michael C. Jensen [~~and~~]**&** William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, **3** Journal of Financial Economics[~~, Vol. 3,~~] 305-360 (1976) **("Jensen and Meckling")**.

[~~56~~]**83** *See, e.g.*, Jensen and Meckling, *supra* [~~note~~][~~55.~~][~~ *See also* the discussion on agency problems in the market for investment advice in Section IV.B. of the Regulation Best Interest Proposal, *supra* note~~]**footnote** [~~5.~~]**82.**

[~~57~~]**84** *See*, *e.g.*, Frank H. Easterbrook [~~and~~]**&** Daniel R. Fischel, *Contract and Fiduciary Duty*, **36** Journal of Law & Economics[~~, Vol. 36,~~] 425-46 (1993).

85 **To the extent that this Final Interpretation clarifies the fiduciary duty for investment advisers, one commenter suggested it may then clarify what clients expect of their investment advisers. *See***

Cambridge Letter (stating that "greater clarity on all aspects of an investment adviser's fiduciary duty will improve the ability to craft such policies and procedures, as well as support the elimination of confusion for retail clients and investment professionals").

[86] As discussed above, whether such a disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the conflict. *See supra* section II.C.

~~potential reduction in agency problems and, consequently, a reduction of agency costs to the client~~discloses about a conflict of interest if the perceived risk associated with the conflict is too significant, and instead try to renegotiate the contract with the adviser or look for an alternative adviser or other financial professional. In addition, the obligation to fully and fairly disclose a current conflict may cause the adviser to take other actions, for example eliminating or adequately mitigating (*i.e.*, modifying practices to reduce) that conflict rather than taking the risk that the client will not provide informed consent or will look for an alternative adviser or other financial professional. The extent to which agency costs would be reduced by such a disclosure is difficult to assess given that we are unable to ascertain [~~whether any~~]the total number of investment advisers that currently interpret their fiduciary duty to [~~be~~]require something different from the Commission's interpretation, [87] and consequently we are not able to estimate the agency costs [~~these~~]such advisers[~~, if any,~~] currently impose on investors. [~~However~~]In addition, we believe that there may be potential benefits for clients of those investment advisers, if any, to the extent [~~the Commission's interpretation~~]this Final Interpretation is effective at strengthening investment advisers' understanding of their obligations to their clients. [~~For example, to the extent that the Commission's interpretation enhances the understanding of any investment advisers of their duty of care, it may potentially raise the quality of investment advice given and that advice's fit with a client's individual profile and preferences or lead to increased compliance with the duty to provide advice and monitoring over the course of the relationship.~~]

[~~Additionally, to the extent the Commission's interpretation enhances the understanding of any investment advisers of their duty of loyalty it may potentially benefit the clients of those~~

~~investment advisers. Specifically, to the extent this leads to a higher quality of disclosures about conflicts for clients of some investment advisers, the nature and extent of such conflict disclosures would help investors better assess the quality of the investment advice they receive, therefore providing an important benefit to investors.~~]Further, to the extent that [~~the interpretation~~]**this Final Interpretation enhances the understanding of any investment advisers of their duty of care, it may potentially raise the quality of investment advice and also lead to increased compliance with the duty to monitor, for example whether advice about an account or program type remains in the client's best interest, thereby increasing the likelihood that the advice fits with a client's objectives.**

In addition, to the extent that this Final Interpretation causes some investment advisers to properly identify circumstances in which [~~disclosure alone cannot cure a conflict of interest, the proposed interpretation~~]**conflicts may be of a nature and extent that it would be**

[87] One commenter did not agree that the discussion of fiduciary obligations in the Proposed Interpretation applied to advisers to funds as well as advisers to retail investors. *See* NVCA Letter. As discussed above, this Final Interpretation has clarified the discussion to address this commenter's concerns and acknowledges that the application of the fiduciary duty of an adviser to a retail client would be different from the specific application of the fiduciary duty of an adviser to a registered investment company or private fund.

difficult to provide disclosure to clients that adequately conveys the material facts or nature, magnitude, and potential effect of the conflict sufficient for clients to consent to it or reject it, or in which the disclosure may not be specific enough for clients to understand whether and how the conflict could affect the advice they receive, this Final Interpretation may lead those investment advisers to take additional steps to [~~mitigate or eliminate the conflict. The interpretation~~]**improve their disclosures or to determine whether adequately mitigating (*i.e.*, modifying practices to reduce) the conflict may be appropriate such that full and fair disclosure and informed consent are possible. This Final Interpretation** may also cause some investment advisers to conclude in some circumstances that [~~even if disclosure would be enough to meet their fiduciary duty, such~~][~~disclosure would have to be so expansive or complex that they instead voluntarily mitigate or eliminate the conflicts of interest. Thus, to the extent the Commission's interpretation~~]**they cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent. We would expect that these advisers would either eliminate the conflict or adequately mitigate (*i.e.*, modify practices to reduce) the conflict such that full and fair disclosure and informed consent would be possible. Thus, to the extent this Final Interpretation** would cause investment advisers to better understand their obligations [~~as part of their fiduciary duty~~]and therefore to [~~make changes to~~]**modify** their business practices in ways that **(i)** reduce the likelihood [~~of conflicted advice or the magnitude of the conflicts, it may~~]**that conflicts and other agency costs will cause an adviser to place its interests ahead of the interests of the client or (ii) help those advisers to provide full and fair disclosure, it would be expected to** ameliorate the agency conflict between investment advisers and their clients[~~, and, in~~]**. In** turn, **this** may improve the quality of advice that the clients receive[~~. This less-conflicted advice may~~] **and** therefore produce higher overall returns for clients and increase the efficiency of portfolio allocation. However, as discussed above, we

would generally expect these effects to be minimal[~~. Finally, this interpretation would also benefit~~] **because we believe that the interpretations we are setting forth in this Final Interpretation are generally consistent with investment advisers' current understanding of their fiduciary duty under the Advisers Act. Finally, this Final Interpretation would also benefit** clients of investment advisers to the extent it assists the Commission in its oversight of investment advisers' compliance with their regulatory obligations.

Investment advisers and the market for investment advice

In general, we expect [~~the Commission's interpretation of an investment adviser's fiduciary duty would~~]**this Final Interpretation to** affirm investment advisers' understanding of the [~~obligations~~]**fiduciary duty** they owe their clients **under the Advisers Act**, reduce uncertainty for advisers, and facilitate their compliance. [~~Furthermore~~]**Further**, by addressing in one release certain aspects of the fiduciary duty that an investment adviser owes to its clients[~~, the Commission's interpretation~~] **under the Advisers Act, this Final Interpretation** could reduce [~~the~~]**investment advisers'** costs associated with comprehensively assessing their compliance obligations. We acknowledge that, as with other circumstances in which the Commission speaks to the legal obligations of regulated entities, 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. Moreover, as discussed above, there may be certain investment advisers who currently understand[~~ the practices necessary to comply with~~] their fiduciary duty to [~~be~~]**require something** different from the[~~standard of conduct in the Commission's interpretation~~] **fiduciary duty described in this Final Interpretation**. Those investment advisers [~~if any, ~~]would experience an increase in their compliance costs as they change their systems, processes**, disclosures,** and behavior, and train their supervised persons, to align with [~~the Commission's interpretation~~]**this Final Interpretation. However, this increase**

in costs would be mitigated by potential benefits in efficiency for investment advisers that are able to understand aspects of their fiduciary duty by reference to a single Commission release that reaffirms—and in some cases clarifies—certain aspects of the fiduciary duty.[88] In addition, and as discussed above, in the case of an investment adviser that believed it owed its clients a lower

[88] **As noted above, *supra* footnote 3, this Final Interpretation** is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles.

standard of conduct, there will be client benefits from the ensuing adaptation of a higher standard of conduct and related change in policies and procedures.

Moreover, to the extent any investment advisers that understood their fiduciary [~~obligation~~]**duty** to [~~be~~]**require something** different from the [~~Commission's interpretation~~]**fiduciary duty described in this Final Interpretation** change their behavior to align with this [~~interpretation~~]**Final Interpretation**, there could[~~potentially~~] also be some economic effects on the market for investment advice. For example, any improved compliance may not only reduce agency costs in current investment advisory relationships and increase the value of those relationships to current clients, it may also increase trust in the market for investment advice among all investors, which may result in more investors seeking advice from investment advisers. This may, in turn, benefit investors by improving the efficiency of their portfolio allocation. To the extent it is costly or difficult, at least in the short term, to expand the supply of investment advisory services to meet an increase in demand, any such new demand for investment [~~adviser~~]**advisory** services could[~~potentially~~] put some upward price pressure on fees. At the same time, however, if any such new demand increases the overall profitability of investment advisory services, then we expect it would encourage entry by new investment advisers[~~—~~]==or hiring of new representatives[~~,~~] by current investment advisers[~~—~~]==such that

competition would increase over time. Indeed, [~~we recognize that~~]the recent growth in the investment adviser segment of the market, both in terms **of number** of firms and number of representatives,[~~[58]~~ -][89] may suggest that the costs of expanding the supply of investment advisory services are currently relatively low.

Additionally, we acknowledge that to the extent certain investment advisers recognize, [~~due to the Commission's interpretation~~]**as a result of this Final Interpretation**, that their [~~obligations to clients are~~]**fiduciary duty is** stricter than [~~how~~]**the fiduciary duty as** they

~~[58 *See* Form CRS Proposal, *supra* note][6,][at Section IV.A.1.d.]~~ currently interpret [~~their fiduciary duty~~]**it**, it could potentially affect competition. Specifically, [~~the Commission's interpretation~~]**this Final**

[89 *See* Relationship Summary Proposal, *supra* footnote 5, at section IV.A.1.d.]

Interpretation of certain aspects of the standard of conduct for investment advisers may result in additional compliance costs **for investment advisers seeking** to meet their fiduciary [~~obligation under the Commission's interpretation~~]**duty**. This increase in compliance costs, in turn, may discourage competition for client segments that generate lower revenues, such as clients with relatively low levels of financial assets, which could reduce the supply of investment [~~adviser~~]**advisory** services and raise fees for these client segments. However, the investment advisers who already are complying with the understanding of their fiduciary duty reflected in [~~the Commission's interpretation, and~~]**this Final Interpretation, and who** may therefore currently have a comparative cost disadvantage, could [~~potentially~~]find it more profitable to compete for the [~~customers~~]**clients** of those investment advisers who would face higher compliance costs as a result of [~~the proposed interpretation~~]**this Final Interpretation**, which would mitigate negative effects on the supply of investment [~~adviser~~]**advisory** services. [~~Furthermore~~]**Further**, as noted above, there has been a recent growth trend in the supply of investment advisory services, which is likely to mitigate any potential negative supply effects from [~~the Commission's interpretation~~]**this Final Interpretation**.[~~59~~]**90**

[~~Finally, to the extent the proposed interpretation would cause~~] ~~some investment advisers to reassess their compliance with their~~[~~disclosure obligations~~], ~~it could lead to a reduction in the expected profitability of~~ [~~certain products associated with particularly conflicted advice for which~~]**One commenter discussed that, in its view, any statement in the Proposed Interpretation that certain circumstances may require the elimination of material conflicts, rather than full and fair disclosure or the mitigation of such conflicts, could lead to an effect on the market and costs to advisers, if such a requirement would cause advisers who had not shared that interpretation to change their business models or product offerings or the ways in which they interact with**

[~~59~~]90 Beyond having an effect on competition in the market for investment adviser services, it is possible that [~~the Commission's interpretation~~]this Final Interpretation could affect competition between investment advisers and other providers of financial advice, such as broker-dealers, banks, and insurance companies. This may be the case if certain investors base their choice between an investment adviser and another provider of financial advice, at least in part, on their perception of the standards of conduct each owes to their customers. To the extent that [~~the Commission's interpretation~~]this Final Interpretation increases investors' trust in investment advisers' overall compliance with their standard of conduct, certain of these investors may become more willing[~~,~~] to hire an investment adviser rather than one of their non-investment adviser competitors. As a result, investment advisers as a group may [~~increase their~~]become more competitive[~~-situation~~] compared to that of other types of providers of financial advice. On the other hand, if [~~the Commission's interpretation~~]this Final Interpretation raises costs for investment advisers, they could become less competitive with other financial [~~services~~]advice providers.

clients.[91] We disagree that this Final Interpretation includes a requirement to eliminate conflicts of interest. As discussed in more detail above, elimination of a conflict is one method of addressing that conflict; when appropriate advisers may also address the conflict by providing full and fair disclosure such that a client can provide informed consent to the conflict.[92] 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.[93] 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

[91] ***See*** **Dechert Letter.**

[92] ***See supra*** **section II.C.**

[93] ***See supra*** **footnotes 78-81 and accompanying text.**

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.[94]

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.[~~60~~]**95** 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 [~~on~~]**regarding** these **types of** investments could [~~potentially~~]**affect efficiency for investors; it could** reduce the efficiency of portfolio allocation [~~of~~]**for** those investors who might otherwise benefit from investment adviser advice [~~on these investments.~~]

[~~IV.~~][~~REQUEST FOR COMMENT REGARDING AREAS OF ENHANCED INVESTMENT ADVISER REGULATION~~][~~In 2011, the Commission issued the staff's 913 Study, pursuant to section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, in which the staff recognized several areas for potential harmonization of broker-dealer and investment adviser regulation.~~][~~61~~][~~We have identified a few discrete areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context, and request comment on those areas. The Commission intends to consider these comments in connection with any future proposed rules or other proposed regulatory actions with respect to these matters.~~]**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**

94 ***See supra* section II.A.**

[60 For example, such products could include highly complex, high cost products with risk and return characteristics that are hard to fully understand for retail investors or mutual funds or fund share classes that may pay higher compensation to investment advisers that are dual registrants, or that the investment adviser and its representatives may receive through payments to an affiliated broker-dealer or third party broker-dealer with which representatives of the investment adviser are associated.]

[61 The staff made two primary recommendations in the 913 Study. The first recommendation was that we engage in rulemaking to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The second recommendation was that we consider harmonizing certain regulatory requirements of broker-dealers and investment advisers where such harmonization appears likely to enhance meaningful investor protection, taking into account the best elements of each regime. In the 913 Study, the areas the staff suggested the Commission consider for harmonization included, among others, licensing and continuing education requirements for persons associated with firms. The staff stated that the areas identified were not intended to be a comprehensive or exclusive listing of potential areas of harmonization. *See* 913 Study *supra* note][38.]

[A.][Federal Licensing and Continuing Education]

[Associated persons of broker-dealers that effect securities transactions are required to be registered with the Financial Industry Regulatory Authority ("FINRA"),][62][and must meet qualification requirements, which include passing a securities qualification exam and fulfilling continuing education requirements.][63][The federal securities laws do not require investment adviser representatives to become licensed or to meet qualification requirements, but most states impose registration, licensing, or qualification requirements on investment adviser representatives who have a place of business in the state, regardless of whether the investment adviser is registered with the Commission or the state.][64][These qualification requirements typically mandate that investment adviser representatives register and pass certain securities exams or hold certain designations (such as Chartered Financial Analyst credential).][65][The staff recommended in the 913 Study that the Commission consider requiring investment adviser representatives to be subject to federal continuing education and licensing requirements.][66]

[62 Generally, all registered broker-dealers that deal with the public must become members of FINRA, a registered national securities association, and may choose to become exchange members. *See* Exchange Act section 15(b)(8) and Exchange Act rule 15b9-1. FINRA is the sole national securities association registered with the SEC under section 15A of the Exchange Act.]

[63 *See* NASD Rule 1021 ("Registration Requirements"); NASD Rule 1031 ("Registration Requirements"); NASD Rule 1041 ("Registration Requirements for Assistant Representatives"); FINRA Rule 1250 ("Continuing Education Requirements").]

[64] *See* 913 Study, *supra* note][38,][at 86. *See also* Advisers Act rule 203A-3(a) (definition of "investment adviser representative").]

[65] *See* 913 Study, *supra* note][38,][at 86-87, 138. The North American Securities Administrators Association ("NASAA") is considering a potential model rule that would require that investment adviser representatives meet a continuing education requirement in order to maintain their state registrations. An internal survey of NASAA's membership identified strong support for such a requirement along with significant regulatory need. NASAA is now conducting a nationwide survey of relevant stakeholders to get their input and views on such a requirement. For more information, see][http://www.nasaa.org/industry-resources/investment-advisers/nasaa-survey-regarding-continuing-education-for-investment-adviser-representatives/.]

[66] Several commenters, cited in the 913 Study, suggested that this was a gap that should be addressed. *See* 913 Study, *supra* note][38,][at 138 (citing letters from AALU, Bank of America, FSI, Hartford, LPL, UBS, and Woodbury).]

[We request comment on whether there should be federal licensing and continuing education requirements for personnel of SEC-registered investment advisers. Such requirements could be designed to address minimum and ongoing competency requirements for the personnel of SEC-registered advisers.][67]

[· Should investment adviser representatives be subject to federal continuing education and licensing requirements?]

[· Which advisory personnel should be included in these requirements? For example, should persons whose functions are solely clerical or ministerial be excluded, similar to the exclusion in the FINRA rules regarding broker-dealer registered representatives? Should a subset of registered investment adviser personnel (such as supervised persons, individuals for whom an adviser must deliver a Form ADV brochure supplement, "investment adviser representatives" as defined in the Advisers Act, or some other group) be required to comply with such requirements?]

[· How should the continuing education requirement be structured? How frequent should the certification be? How many hours of education should be required? Who should determine what qualifies as an authorized continuing education class?]

[· How could unnecessary duplication of any existing continuing education requirement be avoided?]

[· Should these individuals be required to register with the Commission? What information should these individuals be required to disclose on any registration form? Should the

registration requirements mirror the requirements of existing Form U4 or require additional information? Should such registration requirements apply to individuals who]

[67 *See* 913 Study, *supra* note][38,][at 138.]

[provide advice on behalf of SEC-registered investment advisers but fall outside the definition of "investment adviser representative" in rule 203A-3 (because, for example, they have five or fewer clients who are natural persons, they provide impersonal investment advice, or ten percent or less of their clients are individuals other than qualified clients)? Should these individuals be required to pass examinations, such as the Series 65 exam required by most states, or to hold certain designations, as part of any registration requirements? Should other steps be required as well, such as a background check or fingerprinting? Would a competency or other examination be a meritorious basis upon which to determine competency and proficiency? Would a competency or other examination requirement provide a false sense of security to advisory clients of competency or proficiency?]

[· If continuing education requirements are a part of any licensing requirements, should specific topics or types of training be required? For example, these individuals could be required to complete a certain amount of training dedicated to ethics, regulatory requirements or the firm's compliance program.]

[· What would the expected benefits of continuing education and licensing be? Would it be an effective way to increase the quality of advice provided to investors? Would it provide better visibility into the qualifications and education of personnel of SEC- registered investment advisers?]

[· What would the expected costs of continuing education and licensing be? How expensive would it be to obtain the continuing education or procure the license? Do those costs scale, or would they fall more heavily on smaller advisers? Would these]

[requirements result in a barrier to entry that could decrease the number of advisers and advisory personnel (and thus potentially increase the cost of advice)?]

[· What would the effects be of continuing education and licensing for investment adviser personnel in the market for investment advice (*i.e.*, as compared to broker-dealers)?]

[· What other types of qualification requirements should be considered, such as minimum

~~experience requirements or standards regarding an individual's fitness for serving as an investment adviser representative?~~]

[~~B.~~][~~Provision of Account Statements~~]

[~~Fees and costs are important to retail investors.~~][~~68~~][~~but many retail investors are uncertain about the fees they will pay.~~][~~69~~][~~The relationship summary that we are proposing in a concurrent release would discuss certain differences between advisory and brokerage fees to provide investors more clarity concerning the key categories of fees and expenses they should expect to pay, but would not require more complete, specific or personalized disclosures or disclosures about the amount of fees and expenses.~~][~~70~~][~~We believe that delivery of periodic account statements, if they specified the dollar amounts of fees and expenses, would allow clients to readily see and understand the fees and expenses they pay for an adviser's services. Clients would receive account statements close in time to the assessment of periodic account fees, which~~][~~68 *See* Staff of the Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 2012), at iv, *available at* https://~~]~~[~~www.sec.gov/news/studies/2012/917_financial_literacy_study~~][~~_part1.pdf ("With respect to financial intermediaries, investors consider information about fees, disciplinary history, investment strategy, conflicts of interest to be absolutely essential.").~~]**[95] 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.**

[~~69 *See* Angela A. Hung, et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), at xix, *available at* ~~]~~[~~https://www.sec.gov/news/press/2008/2008_1_randiabdreport.pdf~~][~~("In fact, focus group participants with investments acknowledged uncertainty about the fees they pay for their investments, and survey responses also indicate confusion about the fees.").~~]

[~~70 *See* Form CRS Proposal, *supra* note ~~]~~[~~6,~~][~~at Section II.B.4.~~]

[~~could be an effective way for clients to understand and evaluate the cost of the services they are receiving from their advisers.~~]

[~~Broker-dealers are required to provide confirmations of transactions with detailed~~

information concerning commissions and certain other remuneration, as well as account statements containing a description of any securities positions, money balances or account activity during the period since the last statement was sent to the customer.][71][Broker-dealers generally must provide account statements no less than once every calendar quarter. Brokerage customers must receive periodic account statements even when not receiving immediate trade confirmations.][72][Although we understand that many advisers do provide clients with account statements, advisers are not directly required to provide account statements under the federal securities laws. Notably, however, the custody rule requires advisers with custody of a client's assets to have a reasonable basis for believing that the qualified custodian sends an account statement at least quarterly.][73][In addition, in any separately managed account program relying on rule 3a-4 under the Investment Company Act of 1940, the program sponsor or another person designated by the sponsor must provide clients statements at least quarterly containing specified information.][74]

[We request comment on whether we should propose rules to require registered investment advisers to provide account statements, either directly or via the client's custodian, regardless of whether the adviser is deemed to have custody of client assets under Advisers Act]

[71 *See, e.g.*, NASD Rule 2340; FINRA Rule 2232; MSRB Rule G-15. *See also* Exchange Act rule 15c3-2 (account statements); Exchange Act rule 10b-10 (confirmation of transactions).]

[72 *See* Confirmation of Transactions, Securities Exchange Act Release No. 34962 (November 10, 1994).]

[73 Advisers Act rule 206(4)-2(a)(3) (custody rule). The Commission also has stated that an adviser's policies and procedures, at a minimum, should address the accuracy of disclosures made to investors, clients, and regulators, including account statements.]

[74 Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.] ("Investment Company Act") rule 3a-4(a)(4).]

[Rule 206(4)-2 or the adviser is a sponsor (or a designee of a sponsor) of a managed account program relying on the safe harbor in Investment Company Act rule 3a-4.]

[• To what extent do retail clients of registered investment advisers already receive account statements? To what extent do those account statements specify the dollar amounts

~~charged for advisory fees and other fees (*e.g.*, brokerage fees) and expenses? Would retail clients benefit from a requirement that they receive account statements from registered investment advisers? If clients are uncertain about what fees and expenses they will pay, would they benefit from a requirement that, before receiving advice from a registered investment adviser, they enter into a written (including electronic) agreement specifying the fees and expenses to be paid?~~]

[~~· What information, in addition to fees and expenses, would be most useful for retail clients to receive in account statements? Should any requirement to provide account statements have prescriptive requirements as to presentation, content, and delivery? Should they resemble the account statements required to be provided by broker-dealers, under NASD Rule 2340 with the addition of fee disclosure?~~]**investment adviser can provide full and fair disclosure regarding its conflicts and appropriate monitoring.**

[~~· How often should clients receive account statements?~~]

[~~· How costly would it be to provide account statements? Does that cost depend on how those account statements could be delivered (*e.g.*, via U.S. mail, electronic delivery, notice and access)? Are there any other factors that would impact cost?~~]

[~~C.~~][~~Financial Responsibility~~]

List of Subjects in 17 CFR Part 276

[~~Broker-dealers are subject to a comprehensive financial responsibility program. Pursuant to Exchange Act rule 15c3-1 (the net capital rule), broker-dealers are required to maintain minimum levels of net capital designed to ensure that a broker-dealer under financial stress has~~]

[~~sufficient liquid assets to satisfy all non-subordinated liabilities without the need for a formal liquidation proceeding.~~][~~[75]~~][~~Exchange Act rule 15c3-3 (the customer protection rule) requires broker-dealers to segregate customer assets and maintain them in a manner designed to~~

ensure that should the broker-dealer fail, those assets are readily available to be returned to customers.][76][Broker-dealers are also subject to extensive recordkeeping and reporting requirements, including an annual audit requirement as well as a requirement to make their audited balance sheets available to customers.][77-][Broker-dealers are required to be members of the Securities Investor Protection Corporation ("SIPC"), which is responsible for overseeing the liquidation of member broker-dealers that close due to bankruptcy or financial trouble and customer assets are missing. When a brokerage firm is closed and customer assets are missing, SIPC, within certain limits, works to return customers' cash, stock, and other securities held by the firm. If a firm closes, SIPC protects the securities and cash in a customer's brokerage account up to $500,000, including up to $250,000 protection for cash in the account.][78-][Finally, FINRA rules require that broker-dealers obtain fidelity bond coverage from an insurance company.][79]

[Under Advisers Act rule 206(4)-2, investment advisers with custody must generally maintain client assets with a "qualified custodian," which includes banks and registered broker-dealers, and must comply with certain other requirements.][80-][In 2009 the Commission adopted amendments to the custody requirements for investment advisers that, among other]

[75 *See* Exchange Act rule 15c3-1.]

[76 *See* Exchange Act rule 15c3-3.]

[77 *See* Exchange Act rules 17a-3, 17a-4, and 17a-5.]

[78 *See*]

Securities[Investor Protection Act of 1970, Public Law No. 91-598, 84 Stat. 1636 (Dec. 30, 1970),][15] [U.S.C. § 78aaa][through][15 U.S.C. § 78lll.]

[79 *See* FINRA Rule 4360, ("Fidelity Bonds").]

[80 *See* Advisers Act rule 206(4)-2.]

[enhancements, required all registered investment advisers with custody of client assets to undergo an annual surprise examination by an independent public accountant. SEC-registered investment advisers, however, are not subject to any net capital requirements comparable to those applicable to broker-dealers, although they must disclose any material financial condition that impairs their ability to provide services to their clients.][81-][Many investment advisers have relatively small amounts of capital, particularly compared to the amount of assets that they have under management.][82-][When we discover a serious fraud by an adviser, often the assets of the adviser

are insufficient to compensate clients for their loss. In addition, investment advisers are not required to obtain fidelity bonds, unlike many other financial service providers that have access to client assets.][83]

[In light of these disparities, we request comment on whether SEC-registered investment advisers should be subject to financial responsibility requirements along the lines of those that apply to broker-dealers.]

[· What is the frequency and severity of client losses due to investment advisers' inability to satisfy a judgment or otherwise compensate a client for losses due to the investment adviser's wrongdoing?]

[· Should investment advisers be subject to net capital or other financial responsibility requirements in order to ensure they can meet their obligations, including compensation]

[81 *See* Form ADV. Many states have imposed fidelity bonding and/or net capital requirements on state-registered investment advisers. Rule 17g-1 under the Investment Company Act of 1940 requires registered investment companies to obtain fidelity bonds covering their officers and employees who may have access to the investment companies' assets.]

[82 *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2968 (Dec. 30, 2009).]

[83 Fidelity bonds are required to be obtained by broker-dealers (FINRA Rule 4360; New York Stock Exchange Rule 319; American Stock Exchange Rule 330); transfer agents (New York Stock Exchange Rule Listed Company Manual §906); investment companies (17 CFR 270.17g-1); national banks (12 CFR 7.2013); federal savings associations (12 CFR 563.190).]

[for clients if the adviser becomes insolvent or advisory personnel misappropriate clients' assets?][84-][Do the custody rule and other rules][85-][under the Advisers Act adequately address the potential for misappropriation of client assets and other financial responsibility concerns for advisers? Should investment advisers be subject to an annual audit requirement?]

[· Should advisers be required to obtain a fidelity bond from an insurance company? If so, should some advisers be excluded from this requirement?][86-][Is there information or data],

Amendments to the Code of Federal Regulations

[84 We note that Congress and the Commission have considered such requirements in the past. In 1973, a Commission advisory committee recommended that Congress authorize the Commission to adopt minimum financial responsibility requirements for investment advisers, including minimum capital requirements. *See* Report of the Advisory Committee on Investment Management Services for Individual Investors, Small Account Investment Management Services, Fed. Sec. L. Rep. (CCH) No. 465, Pt. III, 64–66 (Jan. 1973)

("Investment Management Services Report"). Three years later, in 1976,] the Senate Committee on Banking[, Housing and Urban Affairs considered a bill that, among other things, would have authorized the Commission to adopt rules requiring investment advisers (i) with discretionary authority over client assets, or (ii) that advise registered investment companies, to meet financial responsibility standards. S. Rep. No. 94-910, 94th Cong. 2d Sess. (May 20, 1976) (reporting favorably S. 2849). S.2849 was never enacted. In 1992, both the Senate and House of Representatives passed bills that would have given the Commission the explicit authority to require investment advisers with custody of client assets to obtain fidelity bonds. S.226, 102d Cong., 2d Sess. (Aug. 12, 1992) and H.R. 5726, 102d Cong. Ed (Sept. 23, 1992). Differences in these two bills were never reconciled and thus neither became law. In 2003, the Commission requested comment on whether to require a fidelity bonding requirement for advisers as a way to increase private sector oversight of the compliance by funds and advisers with the federal securities laws. The Commission decided not to adopt a fidelity bonding requirement at that time, but noted that it regarded such a requirement as a viable option should the Commission wish to further strengthen compliance programs of funds and advisers. Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 25925 (Feb. 5, 2003).]

[85 *See, e.g.*, Advisers Act rule 206(4)-7 (requires each investment adviser registered or required to be registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and Advisers Act rules, review those policies and procedures annually, and designate an individual to serve as a chief compliance officer).]

[86 As noted above, the 1992 legislation would have given us the explicit authority to require bonding of advisers that have custody of client assets or that have discretionary authority over client assets. Section 412 of ERISA [29 U.S.C. 1112] and related regulations (29 CFR 2550.412-1 and 29 CFR 2580) generally require that every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan shall be bonded. Registered investment advisers exercising investment discretion over assets of plans covered by title I of ERISA are subject to this requirement; it does not apply to advisers who exercise discretion with respect to assets in an individual retirement account or other non-ERISA retirement account. In 1992, only approximately three percent of Commission registered advisers had discretionary authority over client assets; as of March 31, 2018, according to data collected on Form ADV, 91 percent of Commission registered advisers have that authority.]**For the reasons set out above, the Commission is amending title 17, chapter II of the Code of Federal Regulations as set forth below:**

[that demonstrates fidelity bonding requirements provide defrauded clients with recovery, and if so what amount or level of recovery is evidenced?]

[·Alternatively, should advisers be required to maintain a certain amount of capital that could be the source of compensation for clients?][87][What amount of capital would be adequate?][88]

[·What would be the expected cost of either maintaining some form of reserve capital or purchasing a fidelity bond? Specifically, in addition to setting aside the initial sum or

purchasing the initial bond, what would be the ongoing cost and the opportunity cost for investment advisers? Would one method or the other be more feasible for certain types of investment advisers (particularly, smaller advisers)?]

[· Would the North American Securities Administrators Association Minimum Financial Requirements For Investment Advisers Model Rule 202(d)-1][89][(which requires, among other things, an investment adviser who has custody of client funds or securities to maintain at all times a minimum net worth of $35,000 (with some exceptions), an adviser who has discretionary authority but not custody over client funds or securities to maintain at all times a minimum net worth of $10,000, and an adviser who accepts prepayment of more than $500 per client and six or more months in advance to maintain at all times a positive net worth), provide an appropriate model for a minimum capital requirement? Why or why not?]

[87 *See supra* note][84.]

[88 Section 412 of ERISA provides that the bond required under that section must +be at least ten percent of the amount of funds handled, with a maximum required amount of $500,000 (increased to $1,000,000,000 for plans that hold securities issued by an employer of employees covered by the plan).]

[89 NASAA Minimum Financial Requirements For Investment Advisers Model Rule 202(d)-1 (Sept. 11, 2011), *available at*][http://www.nasaa.org/wp-content/uploads/2011/07/IA-Model-Rule-Minimum-] [Financial-Requirements.pdf.]

[· Although investment advisers are required to report specific information about the assets that they manage on behalf of clients, they are not required to report specific information about their own assets.][90][Should advisers be required to obtain annual audits of their own financials and to provide such information on Form ADV? Would such a requirement raise privacy concerns for privately held advisers?]

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 list of interpretive releases.

By the Commission.

Dated: [~~April 18, 2018.~~]**June 5, 2019**

[~~Brent J. Fields~~]**Vanessa A.**

Countryman, Acting Secretary**.**

[~~90 Form ADV only requires that advisers with significant assets (at least $1 billion) report the approximate amount of their assets within one of the three ranges ($1 billion to less than $10 billion, $10 billion to less than $50 billion, and $50 billion or more). Item 1.O of Part 1A of Form ADV.~~]

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