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The Dog That Didn't Bark: Investment Research, Hard Dollars and Special Compensation under the Investment Advisers Act of 1940

By Ethan Corey

> Inspector Gregory (Scotland Yard detective): Is there any other point to which you would wish to draw my attention?
>
> Sherlock Holmes: To the curious incident of the dog in the night-time.
>
> Gregory: The dog did nothing in the night-time.
>
> Holmes: That was the curious incident.[1]

On October 26, 2017, the Staff of the Securities and Exchange Commission (SEC) issued three no-action letters intended to facilitate the ability of registered investment advisers and broker-dealers to comply both with the requirements of the Investment Advisers Act of 1940, as amended (Advisers Act) and with the requirements of MiFID II.[2] One of the letters was issued to the Securities Industry and Financial Markets Association (SIFMA Letter)[3] and expires by its terms 30 months after the January 3, 2018 implementation date of MiFID II. Among other things, the SIFMA Letter enabled broker-dealers to accept hard dollar payments for investment research from money managers that were either directly or contractually required to comply with MiFID II, as MiFID II effectively prohibited soft dollar payments for research. The unstated assumption behind the SIFMA Letter was that a broker-dealer that accepted a hard dollar payment for investment research that constituted investment advice under the Advisers Act would be required to register as an investment adviser absent the relief. This article argues that: (1) until recently, the SEC has never contemplated requiring a broker-dealer to register as an investment adviser solely because it accepts a hard dollar payment for research that could constitute investment advice, even in instances where the SEC has specifically contemplated that a hard dollar payment would be required; and (2) a close examination of applicable SEC and Supreme Court precedent helps to explain why the SEC has never done so.

The Advisers Act, the Broker-Dealer Exclusion and the Meaning of "Special Compensation"

Section 202(a)(11) of the Advisers Act broadly defines the term "investment adviser" to mean "any

person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[4] Section 202(a)(11) then sets forth a series of exclusions from the definition of investment adviser. The so-called broker-dealer exclusion, set forth in Section 202(a)(11)(C) excludes "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."[5]

The SEC's General Counsel was asked to interpret the scope of the broker-dealer exclusion shortly after the Advisers Act was enacted. The General Counsel was presented with four separate scenarios in which a broker received compensation for providing investment advice. The General Counsel was asked to opine about whether, in each scenario, the compensation constituted special compensation.

The General Counsel's opinion stated:

> Clause (C) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause (C) which refers to "special compensation" amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the [Advisers] Act merely because he is also engaging in effecting market transactions in securities, It is well known that many brokers and dealers have investment advisory departments which furnish investment advice for compensation in the same manner as does an investment adviser who operates solely in an advisory capacity. The essential distinction to be borne in mind in considering borderline cases, such as those which you have presented, is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental.[6]

The General Counsel's opinion stated that instances in which a broker charged a client a separately identifiable service charge or overriding commission for advice that was not charged to clients who did not receive advice amounted to the broker's receipt of special compensation.[7]

More recently, the scope of the broker-dealer exclusion was considered in connection with the SEC's attempt to adopt a rule under the Advisers Act excluding broker-dealers charging asset-based fees instead of commissions from the definition of investment adviser, and consequently, the requirement to register as an investment adviser. The SEC stated in its 2005 release adopting the rule (2005 Release) that a broker-dealer receiving an asset-based fee "may be unable to rely on the statutory broker-dealer exception because the fee constitutes 'special compensation' under the [Advisers] Act—*i.e.*, it involves the receipt by a broker-dealer of compensation other than brokerage commissions or dealer compensation (*i.e.*, mark-ups, mark-downs, or similar fees)."[8] The rule provided, among other things, that a broker-dealer charging an asset-based fee would be deemed to be receiving special compensation, but would not be deemed to be an investment adviser if any advice provided was solely incidental to brokerage services provided on a customer's account and certain disclosure was made to the customer.

The Financial Planning Association (FPA) then challenged the final rule on the ground that the SEC exceeded its statutory authority in adopting the rule.[9] A divided panel of the DC Circuit held that the SEC did indeed exceed its authority in adopting the rule and vacated the rule.[10] Since then, the SEC

consistently has taken the position that investment advice provided by a broker-dealer and paid for other than through commissions would require the broker-dealer to register as an investment adviser.[11]

Broker-Dealers, Investment Research, Soft Dollars and Hard Dollars: Unasked Questions

The 2005 Release included an extensive discussion of the legislative history of the broker-dealer exclusion. The Release noted that:

> By 1940, when the Advisers Act was enacted, broker-dealers were providing investment advice in two distinct ways—as an auxiliary part of the traditional brokerage services for which their brokerage customers paid fixed commissions and, alternatively, as a distinct advisory service for which their advisory clients separately contracted and paid a fee.
>
> The advice that broker-dealers provided as an auxiliary component of traditional brokerage services was referred to as "brokerage house advice" in a leading study of the time. "Brokerage house advice" was extensive and varied, and included information about various corporations, municipalities, and governments; broad analyses of general business and financial conditions; market letters and special analyses of companies' situations; information about income tax schedules and tax consequences; and "chart reading." The principal sources of auxiliary advice were firm representatives—known as "customers' men" until 1939 —who served as the main point of contact with brokerage customers, and the "statistical departments" within firms, which provided research and analysis to customers' men or directly to the firms' brokerage customers.
>
> The second way in which broker-dealers dispensed advice was to charge a distinct fee for advisory services, which typically were provided through special "investment advisory departments" within broker-dealer firms that advised customers for a fee in the same manner as did firms whose sole business was providing "investment counsel" services. Through these special departments, broker-dealers offered two types of advisory accounts, one known as "purely advisory" and the other as "discretionary." In purely advisory accounts, the "investment counsel undert[ook] to advise the client at stated intervals, or to keep him constantly advised, as to what changes ought, in the opinion of counsel, to be made in his holdings" but left the ultimate decision about such changes to the client. Discretionary advisory accounts, on the other hand, provided the broker-dealer—through powers of attorney or otherwise—additional "control over the client's funds, with the power to make the ultimate determination with respect to the sale and purchase of securities for the client's portfolio." Broker-dealers generally charged for the advisory services provided to these accounts under the same system that had been adopted by the independent investment counseling firms—a fee based on a percentage of the market value of the cash and securities in the account being supervised. Securities transactions for the discretionary accounts were effected through the broker-dealer, and clients paid a commission on each trade.[12]

The 2005 Release went on to note that while the Advisers Act broadly defines the term "investment adviser," it includes a number of specific exceptions intended to exclude entities that were already otherwise "subject to substantial oversight and regulation."[13] Consequently, the Release stated, the broker-dealer exclusion was crafted to exclude broker-dealers that offered investment advice as part of their traditional commission brokerage services.[14]

However, broker-dealers that offered investment advice for a separate fee through special departments could not rely upon the broker-dealer exclusion.[15]

After the 2005 Release was issued and after the FPA challenged the SEC rule, the SEC issued two further releases that addressed broker-dealers' receipt of compensation for investment research. Each release contemplated instances in which a broker-dealer could be paid hard dollars for investment research, yet neither release even contemplated the possibility that such hard dollar payments could trigger the requirement to register as an investment adviser by virtue of constituting special compensation for investment advice.

2006 Soft Dollar Interpretation

In the 1970s, as commission rates were unfixed, money managers expressed concern that if they paid a commission rate higher than the lowest available commission rate, they would be deemed to have breached their fiduciary duty to clients, even if the higher commission rate enabled them to obtain useful research.[16] In response to these concerns, Congress enacted Section 28(e) of the Securities Exchange Act of 1934 (Exchange Act).[17] Section 28(e) of the Exchange Act provides a safe harbor to protect money managers from liability for a breach of fiduciary duty solely on the basis that they paid more than the lowest commission rate in order to receive "brokerage and research services" provided by a broker-dealer. In order for a manager to rely on the safe harbor, it must determine in good faith that the amount of the commission was reasonable in relation to the value of the brokerage and research services received.[18] Section 28(e)(3) describes the services that constitute "brokerage and research services," namely:

> (A) furnish[ing] advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities; (B) furnish[ing] analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or (C) effect[ing] securities transactions and perform[ing] functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.[19]

While the relevant language of Section 28(e)(3) has not been amended since 1975, the SEC has issued three separate releases interpreting the meaning of "brokerage and research services," most recently on July 18, 2006.[20] The 2006 Release addressed, among other things, the types of services and products that the SEC identified as potentially encompassed within the meaning of "brokerage and research services" for purposes of the Section 28(e) safe harbor.[21] Significantly for our discussion, the SEC also addressed instances in which a money manager would be required to pay hard dollars for all or a portion of a product that might otherwise be encompassed within the safe harbor and therefore could be purchased with client commission dollars.

The SEC first articulated a three-step framework for determining whether the use of client commissions to purchase a particular product or service would be consistent with the safe harbor:

> First, the money manager must determine whether the product or service falls within the specific statutory limits of Section 28(e)(3) (*i.e.*, whether it is eligible "research" under Section 28(e)(3)(A) or (B) or eligible "brokerage" under Section 28(e)(3)(C)). Second, the manager must determine whether the eligible product or service actually provides lawful and appropriate assistance in the performance of his investment

> decision-making responsibilities. Where a product or service has a mixed use, a money manager must make a reasonable allocation of the costs of the product according to its use. Finally, the manager must make a good faith determination that the amount of client commissions paid is reasonable in light of the value of products or services provided by the broker-dealer.[22]

Later in the 2006 Release, the SEC focused on mixed use items and the requirement that a money manager determine in good faith that client commissions paid are reasonable in relation to the value of the brokerage and research services received. The SEC noted that some money managers use portfolio performance evaluation services both to assist them in investment decisionmaking (for example, by assessing how past investment decisions have affected portfolio performance) and to use in marketing materials.[23] The SEC stated that while "an allocable portion of the cost of portfolio performance evaluation services or reports may be eligible as research, . . . money managers must use their own funds to pay for the allocable portion of such services or reports that is used for marketing purposes." With respect to the required good faith determination, the SEC noted that one "money manager may purchase an eligible item of research with client commissions if he or she properly uses the information in formulating an investment decision, but another money manager cannot rely on Section 28(e) to acquire the very same item if the manager does not use the item for investment decisions or if the money manager determines that the commissions paid for the item are not reasonable with respect to the value of the research or brokerage received."

From the standpoint of the broker-dealer providing the service or product, to the extent that the service or product constitutes "advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities" or "analyses and reports concerning . . . securities," if the broker-dealer accepts a hard dollar payment, it would appear that the broker-dealer is accepting special compensation for investment advice. One would have assumed that the SEC would have at least addressed the issue in the 2006 Release. Yet nowhere does the 2006 Release discuss investment adviser registration issues triggered by a broker-dealer's acceptance of hard dollar payments from money managers for products constituting "advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities" or "analyses and reports concerning . . . securities."

2008 Proposed Soft Dollar Guidance

On July 30, 2008, the SEC issued proposed guidance intended to assist investment company (fund) boards of directors as they oversaw, among other things, the use of fund brokerage commissions by fund investment advisers to purchase research.[24] The SEC stated in the 2008 Release that a fund adviser may use a portion of fund brokerage commissions to purchase proprietary or third party research and/or research-related services in accordance with Section 28(e) of the Exchange Act.[25] The 2008 Release then stated that investment advisers also may purchase third-party research themselves using cash payments from their own account, or "hard dollars."[26] The release discussed various conflicts of interests that arise when advisers use fund portfolio brokerage commissions to purchase research[27] and then set forth a laundry list of questions for fund boards to pose to advisers in determining whether to approve an adviser's soft dollar policies and procedures:

- How does the adviser determine the total amount of research to be obtained and how will the research actually be obtained? In particular:

- How does the adviser determine the amount to be spent using hard versus soft dollars?
- How does the adviser determine amounts to be spent on proprietary versus third-party research arrangements?
- What types of research products and services will the adviser seek to obtain and how will this research be beneficial to the fund?
- How does the adviser determine amounts to be used in commission recapture programs and expense reimbursement programs?
- What is the process for establishing a soft dollar research budget and determining brokerage allocations in the soft dollar program? Is a broker vote process or some other mechanism used?
- Do any alternative trading venues that are used produce soft dollar credits? If so, how much?
- How does the adviser determine that the use of soft dollars is within the Section 28(e) safe harbor? In particular:
- Is the product or service obtained eligible brokerage or research, as defined under Section 28(e)?
- Does the product or service provide lawful and appropriate assistance to the adviser in carrying out its investment decisionmaking responsibilities?
- Is the amount of commissions paid reasonable (based on a good faith determination) in light of the value of brokerage and research services provided by the broker-dealer?
- How does soft dollar usage compare to the adviser's total commission budget?
- How are soft dollar products and services allocated among the adviser's clients? Are the commissions paid for certain trades in fund portfolio securities similar to commissions paid for transactions in similar securities, or of similar sizes, by the fund and the adviser's other clients (including clients that are not funds)? Are other clients paying lower commissions that do not include a soft dollar component? If so, does the adviser adequately explain the discrepancy in commission rates and provide the board data sufficient to satisfy the board that the fund is not subsidizing the research needs of the adviser's other client? To what extent are the products and services purchased through soft dollar arrangements used for the benefit of fixed-income or other funds that generally do not pay brokerage commissions?
- What is the process for assessing the value of the products or services purchased with soft dollars?
- What is the process used to evaluate the portion of a mixed use product or service that can be paid for under Section 28(e)?
- To what extent does the adviser use client commission arrangements? What effect do these arrangements have on how the adviser selects a broker-dealer to complete a particular transaction? How does the adviser explain that the use of client commission arrangements benefits the fund? [28]

Interestingly, one question that is *not* addressed in the list is the ability of the investment adviser to obtain the same products or services from broker-dealers if it paid hard dollars. One would assume that if a broker-dealer would be unwilling to make research available to an investment adviser for hard dollars because the hard dollar payment would trigger investment adviser registration, a fund board would want to know this fact before instructing its investment adviser to cease using soft dollars to pay for research. Yet, not only is this issue unaddressed in the 2008 Release, none of the commenters on the 2008 Release address this issue. And while the 2006 Release was issued before the FPA Decision was issued, the SEC issued the 2008 Release after the FPA Decision was issued, and therefore, had to have been aware of its import.

Nor is it likely that the SEC or its Staff simply were not confronted directly with the exact issue and therefore elected not to address it. For in 2003, the Staff of the Division of Market Regulation responded to a no-action request on behalf of Edward Mahaffy,

a registered representative of a broker-dealer.[29] Mr. Mahaffy requested confirmation that his customers not be considered broker-dealers solely because they owned mutual fund shares with respect to which they received partial refunds of Rule 12b-1 fees. The Market Regulation Staff agreed not to recommend enforcement action against Mr. Mahaffy's customers for not registering as broker-dealers solely because they received partial refunds of Rule 12b-1 fees. Significantly, however, the letter included the following excerpt:

> You have not asked for any guidance as to whether your proposal implicates any provisions of the 1940 Act. Nevertheless, the staff of the Division of Investment Management questions whether direct or indirect rebates of 12b-1 fees by a fund are consistent with the policies and provisions of the 1940 Act. . . . The staff of the Division of Investment Management believes that a broker-dealer's practice of rebating to its customers all or a portion of 12b-1 fees paid by the fund to the broker-dealer would be a pertinent factor requiring a board of directors' full consideration in reaching its conclusion with respect to a fund's 12b-1 plan, and the staff of the Division of Investment Management questions whether a 12b-1 plan under which broker-dealers rebate 12b-1 fees to their customers would benefit the fund and its shareholders.[30]

Clues and Answers

The first clue in determining why the SEC never addressed investment adviser registration issues in connection with hard dollar payments for investment research may be found in the Supreme Court decision of *Lowe v. SEC* (*Lowe*).[31] While *Lowe* on its face dealt with the scope of the exclusion from the definition of investment adviser for "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation"—the so-called publishers exclusion found in Section 202(a)(11)(D) of the Advisers Act,[32] much of the opinion is devoted to the history and the legislative intent of the Advisers Act. The court stated that "[t]he [Advisers] Act was designed to apply to those persons engaged in the investment-advisory profession—those who provide personalized advice attuned to a client's concerns, whether by written or verbal communication. The mere fact that a publication contains advice and comment about specific securities does not give it the personalized character that identifies a professional investment adviser."[33]

Turning to the newsletters at issue in *Lowe*, the Supreme Court stated that "[a]s long as the communications between petitioners and their subscribers remain entirely impersonal and do not develop into the kind of fiduciary, person-to-person relationships that were discussed at length in the legislative history of the [Advisers] Act and that are characteristic of investment adviser-client relationships, we believe the publications are, at least presumptively, within the exclusion, and thus not subject to registration under the Act." While the broker-dealer exclusion does not mirror the publishers exclusion, the SEC, when viewing the impersonal nature of most investment research and the lack of fiduciary relationship that exists between a money manager and a broker-dealer when a broker-dealer utilizes client commissions to purchase research, may have declined to impose a fiduciary relationship when the investment adviser was using its own resources to purchase research.

However, there is an even more significant clue than *Lowe* in determining why the SEC never addressed investment adviser registration issues in connection with hard dollar payments for investment research. That clue can be found in a 1972 SEC release anticipating the unfixing of brokerage commissions (Future Structure Release).[34] Interestingly, the Future Structure Release was cited in the 2005 Release for the proposition that advice broker-dealers gave as part of their traditional brokerage services

in 1940 continued to be a substantial and important part of the services provided to the customer in the following decades.[35] Yet, later in the Future Structure Release is a discussion about investment research that the author believes helps to explain why the SEC and its Staff did not, until the SIFMA No-Action Letter, take the position that a broker-dealer that accepts hard dollar payments for investment research may need to register as an investment adviser.

The SEC stated that "[i]f fixed minimum commissions were no longer to be applicable to institutional size transactions, an 'unbundling' process might result so that some brokers would charge separate fees for services such as execution, research and the like . . . In our opinion, the providing of investment research is a fundamental element of the brokerage function for which the bona fide expenditure of the beneficiary's funds is completely appropriate, whether in the form of higher commissions or outright cash payments."[36] The SEC tied the research function to the broker's suitability obligation. It noted that a broker is required to obtain basic information about a security and then to make an evaluation as to the suitability of a recommendation for a particular customer taking into account both the information about the security and the broker's knowledge about the customer's needs.[37] In other words, because investment research is a fundamental element of the brokerage function, rather than being "solely incidental" to the conduct of the broker-dealer's business as a broker or dealer, it is intrinsic to the conduct of broker-dealer's business as a broker or dealer. Consequently, investment research would not constitute investment advisory services in the view of the SEC and one would not need to address the issue of whether the broker or dealer accepted special compensation for the investment research.

Then-SEC Chairman William Casey affirmed the view that investment research was a brokerage function in an October 1972 speech.[38] Casey stated "[r]esearch should be part of the brokerage function, and the availability of research and knowledge in which an investor is or may be interested is a proper consideration in the selection of a brokerage firm for any transaction and in the commission rate which the firm charges for its services."[39] One part of Casey's speech focused on the possibility of unbundling research from execution in an environment of negotiated commission rates:

> Under competitive commissions, research which is not unbundled but offered as part of a broker's service must be viewed as something which enhances the quality of the brokerage service, not as a separate, severable commodity. There are those who advocate a severance—which is the concept of so-called "unbundling"—as appropriate for a competitive rate system. As I have had an opportunity to remark on other occasions, I do not dispute that it is perfectly all right for those who want to sell and buy research for hard cash, to do so. But to mandate the separation of research and brokerage strikes me as quite unnecessary and impractical and harmful. It is doubtful that voluntary unbundling would make any significant contribution to maintaining the professionalism, the quality or the research content of brokerage services.[40]

Chairman Casey thus implied that a problem with unbundling would be its impact on brokerage. Not surprisingly, the Chairman did not discuss the idea that any unbundled payment for research would trigger a requirement for a broker-dealer recipient to register as an investment adviser.

Chairman Casey gave another speech earlier in 1972 which also discussed payment for research in an environment of negotiated commission rates.[41] While his speech touched on many of the same themes as the speech discussed above, one portion of the speech foreshadowed some of the arguments made in *Lowe* about the purpose and the intended beneficiaries of the Advisers Act.

> There is the view that a fund adviser who takes a money management fee thereby incurs an obligation to provide all the necessary research. It is true that he does incur an obligation to make the necessary investment decisions and to do so in a sound knowledgeable way. That implies that he will rely on a research function. *But it should be realized that it takes judgment and skill to evaluate research*. It should also be realized that the research universe is quite infinite, covering thousands of companies and products and the impact of an endless number of variables. Even a money manager who does employ analysts cannot claim to have all the research he needs. Selection, cross-checking of opinions and breadth of coverage is important. *The research function here, more often than not, consists of screening the research of others.* (emphasis added.)[42]

Here, Chairman Casey appears to be viewing research as a product or service that an institutional investor should not use without first performing its own due diligence on it. Research, then, would not appear to be viewed as a product that is characteristic of a fiduciary, person-to-person relationship that, according to *Lowe*, the Advisers Act was intended to cover.

Conclusion

Until the SIFMA Letter, the SEC and its Staff had never formally taken the position that a broker-dealer that accepted a hard dollar payment for investment research that constituted investment advice under the language of Section 202(a)(11) of the Advisers Act may have to register as an investment adviser because it would not be able to avail itself of the broker-dealer exclusion. This is not because the SEC was never confronted with the issue before—in fact, it had been confronted with the issue on several occasions. Nor is it because investment research necessarily falls outside the scope of activities articulated in Section 202(a)(11) as causing someone to be deemed to be an investment adviser.

Rather, it appears more likely that the SEC has traditionally thought of investment research as being an integral part of the brokerage function, even if it were paid for separately in an unbundled environment. Moreover, the belief that institutional advisers should perform their own due diligence on investment research received would indicate that investment research was not the type of fiduciary, person-to-person relationship that the Advisers Act was intended to cover. Therefore, the SEC chose not to attempt to apply the Advisers Act to unbundled payments to broker-dealers for investment research.

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NOTES

1 A.C. Doyle, The Complete Sherlock Holmes, Vol. 1 (Barnes & Noble Classics 2003) Silver Blaze, p. 413.

2 *See* "SEC Announces Measures to Facilitate Cross-Border Implementation of the European Union's MiFID II's Research Provisions" (*https://www.sec.gov/news/press-release/2017-200-0*) (visited July 8, 2019). "MiFID II" means Directive 2014/65/EU of the European Parliament and of the Council of May, 15, 2014 on markets in financial instruments and amending Directive 2011/61/EU, as implemented by the European Union member states.

3 Securities Industry and Financial Markets Association, SEC Staff No-Action Letter (pub. avail. Oct. 26, 2017).

4 15 U.S.C. § 80b-2(11). The SEC Staff has stated that it interprets "engages in the business" and "as part of a regular business" in the same manner. *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons who Provide Investment Advisory Services as a Component of Other Financial Services,* Investment Advisers Act Rel. No. 1092 (Oct. 8, 1987), 52 Fed. Reg. 38,400, 38,402 (Oct. 16, 1987).

[5] 15 U.S.C. §80b-2(11)(C).

[6] *Opinion of Chester T. Lane, SEC General Counsel*, Investment Advisers Act Rel. No. 2, 11 Fed. Reg. 10,996 (Sept. 27, 1946) (republishing SEC General Counsel opinion letter of Oct. 28, 1940).

[7] *Id.*

[8] *Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Investment Advisers Act Rel. No. 2376 (Apr. 12, 2005), 70 Fed. Reg. 20,423, 20,425 & n. 10 (Apr. 19, 2005) (2005 Release).

[9] Financial Planning Association v. Securities and Exchange Commission, 482 F. 3d 481 (D.C. Cir. 2007) (FPA Decision).

[10] *Id.*

[11] *See, e.g., Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, Investment Advisers Act Rel. No. 5249 (June 5, 2019), 84 Fed. Reg. 33,681, 33,683 n.17 (July 12, 2019); "General Information on the Regulation of Investment Advisers," *https://www.sec.gov/divisions/investment/iaregulation/memoia.htm (visited June 20, 2019).*

[12] 2005 Release, *supra* n.8, 70 Fed. Reg. at 20,428-29 (citations omitted).

[13] *Id.*, 70 Fed. Reg. at 20,430.

[14] *Id.*, 70 Fed. Reg. at 20,431.

[15] *Id.*

[16] *See Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Securities Exchange Act Rel. No. 54165 (July 18, 2006), 71 Fed. Reg. 41,977, 41,980 (July 24, 2006) (2006 Release).

[17] 15 U.S.C. § 78bb(e).

[18] 2006 Release, *supra* n.16, 71 Fed. Reg. at 41,978.

[19] 15 U.S.C § 78bb(e)(3). It should be noted that "advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities" and "analyses and reports concerning . . . securities" is language that is almost identical to the language in Section 202(a)(11) of the Advisers Act that describes the scope of activities that cause a person to be deemed to be an investment adviser.

[20] *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Securities Exchange Act Rel. No. 54165 (July 18, 2006), 71 Fed. Reg. 41,977 (July 24, 2006).

[21] *See id.*, 71 Fed. Reg. at 41,979.

[22] *Id.*, 71 Fed. Reg. at 41,985 (citations omitted).

[23] *Id.*, 71 Fed. Reg. at 41,990-91.

[24] *Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors With Respect to Investment Adviser Portfolio Trading Practices*, Investment Company Act Rel. No. 28345 (July 30, 2008), 73 Fed. Reg. 45,646 (Aug. 6, 2008) (2008 Release).

[25] *Id.*, 73 Fed. Reg. at 45,652. Interestingly, the 2008 Release defined proprietary research and third-party research differently from the 2006 Release. The 2008 Release defined proprietary research as research produced by the broker-dealer *executing* the transaction or its affiliates, and third party research as research "produced or provided by someone other than the executing broker-dealer". *Id.* By contrast, the 2006 Release defined proprietary research as research produced by a broker-dealer involved in *effecting* the transaction, a broader concept which encompasses not only execution, but clearance, settlement or the performance of "at least one of four minimum functions and tak[ing] steps to see that the other functions have been reasonably allocated to one or another of the broker-dealers in the arrangement in a manner that is fully consistent with their obligations under SRO and Commission rules." 2006 Release, *supra* n.16, 71 Fed. Reg. at 41,994. The SEC went on to note that "[i]n Section 28(e) arrangements involving multiple broker-dealers, at least one of the broker-dealers (but not necessarily all) must satisfy the requirements for 'effecting' transactions and 'providing' research." *Id.*, 71 FR at 41,995 n. 182.

[26] 2008 Release, *supra* n.24, 73 Fed. Reg. at 45,652. Curiously, the SEC failed to explain why investment advisers could not also purchase proprietary research with hard dollars. However, elsewhere in the 2008 Release, the SEC implied that investment advisers

could purchase proprietary research with hard dollars. *See*, *e.g.*, *id.,* 73 Fed. Reg. at 45,653 n. 68 ("[S]ection 28(e) contemplates that funds could enter into contracts to reduce or eliminate an adviser's ability to rely on the safe harbor").

27 *Id.*, 73 Fed. Reg. at 45,652.

28 *Id.*, 73 Fed. Reg. at 45,654 (citations omitted).

29 Edward Mahaffy, SEC Staff No-Action Letter (pub. avail. Mar. 6, 2003).

30 *Id*.

31 Lowe v. SEC, 472 U.S. 181 (1985).

32 15 U.S.C. § 80b-2(11)(D).

33 *Lowe*, 472 U.S. at 208-209 (citations omitted).

34 *Interpretive Releases Relating to the Securities Exchange Act of 1934 and General Rules and Regulations Thereunder: Future Structure of Securities Markets* (Feb. 2, 1972), 37 Fed. Reg. 5286 (Mar. 14, 1972).

35 2005 Release, *supra* n.8, 70 Fed Reg. at 20,437 & n. 141.

36 *Future Structure Release*, *supra* n.34, 37 Fed. Reg. at 5290.

37 *Id.*

38 "Quality Service in Brokerage," speech by SEC Chairman William J. Casey (Oct. 11, 1972), *https://www.sec.gov/news/speech/1972/101172casey.pdf* (visited July 2, 2019).

39 *Id.*

40 *Id.*

41 "Research in the Changing Structure and Economics of the Securities Markets," speech by SEC Chairman William J. Casey (May 22, 1972), *https://www.sec.gov/news/speech/1972/052272casey.pdf* (visited July 2, 2019).

42 *Id.*