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THE TIME FOR A UNIFORM FIDUCIARY DUTY IS NOW

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INTRODUCTION

Warren Buffet famously said, "It's only when the tide goes out that you learn who's been swimming naked."[1] The 2008 mortgage meltdown brought to light fraud of an unprecedented nature, perpetrated through the sale of defective or fraudulent securities.[2] With investor confidence already shaken by the Enron, WorldCom, HealthSouth, and Tyco scandals, banks peddled high-risk mortgages to less-than-creditworthy borrowers chasing the American dream of home ownership. When mortgages and the housing market unraveled, chaos followed.

The 2008 collapse led to the government-brokered sale of Bear Stearns, the collapse of Lehman Brothers, the fire sales of Merrill Lynch and Wachovia, and government takeovers of AIG and Washington Mutual. Billion dollar Ponzi schemes orchestrated by Bernard L. Madoff, R. Allan Stanford, and Scott W. Rothstein, and product scandals like the Abacus CDO placement, which demonstrated how large investment banks take substantial positions against their own customers, have rocked investor confidence. The disappearance of customer money at MF Global, reports of LIBOR rigging by multinational

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[1] Alex Crippen, *Warren Buffett and the Perils of Swimming Naked*, CNBC (Aug. 6, 2007, 1:38 PM), http://www.cnbc.com/id/ 20147026/Warren_Buffett_and_the_Perils_of_Swimming_Naked.

[2] *See, e.g.*, *Bozeman Man Faces Up to 200 Years for Investment Scam*, MONT. COMM'R OF SEC. & INS. (Mar. 22, 2012), http://sao.mt.gov/news/2012/03222012_reynoldswanted.asp (describing a Ponzi scheme victimizing individuals from twenty-one states and six countries).

banks, the recent near collapse of market-maker Knight Capital, and the botched Facebook IPO provide constant reminders to Main Street investors who were wiped out by Wall Street. In isolation, these events are problematic. Together, they emphasize the economic reality that the time for a strong broad-based fiduciary duty is now.

The 2008 collapse focused attention on how to better protect investors from securities sellers and advisers who purport to offer unbiased advice, yet do not disclose meaningful conflicts of interest. The push to protect ordinary investors by imposing a uniform fiduciary duty for brokers and investment advisers has gained momentum.[3] This Article examines differences in the standard of care currently owed by financial professionals and the arguments for and against imposing a uniform fiduciary standard.

I. THE 2008 CREDIT CRISIS REQUIRES REMEDIAL ACTION

In the years leading up to the 2008 meltdown, investors were sold securities marketed as safe, secure, and income-producing by investment advisers and broker-dealers. In truth, investors were sold funds that owned toxic tranches of subprime mortgage securities and other byproducts of the real estate boom. In 2009, the U.S. Securities and Exchange Commission ("SEC") Chairman, Mary L. Schapiro, recognized that these complex financial products impaired an investor's ability to make an informed decision:

> This marketplace demands that we constantly find new approaches and strategies, build new tools and think of new ways to out-compete the competition.
>
> This push for innovation constantly changes the face of the financial industry, as smart minds discover new ways to create wealth or manage risk. No doubt, great good can come from this. It can enable vibrant markets where entrepreneurs can access the capital they need to transform their vision into new products and personal success.
>
> But innovation creates challenges as well.

[3] Sharon Epperson & Chris Murphey, *Debate Continues Over Standards for Advisors, Broker-Dealers*, CNBC (May 11, 2011, 1:44 PM), http://www.cnbc.com/id/42650944/Debate_Continues_Over_Standards_for_Advisors_Broker_Dealers; Tara Siegel Bernard, *Dear S.E.C., Please Make Brokers Accountable to Customers*, N.Y. TIMES, Nov. 20, 2010, at B1.

> It can foster incredibly complex financial products that fail to live up to buyers' expectations, but generate fees for their creators and sellers. This complexity can bury important information needed for effective decision-making, so that even the most sophisticated are unable to make informed judgments about risk and payoff. Finally, it can mask old-fashioned manipulation and fraud.
>
> But whether innovation is used for good or ill, to improve the system or to manipulate it—it creates a challenge for regulators with limited resources trying to keep up with the industries they regulate.
>
> This was particularly true when I became Chairman of the SEC in late January 2009 in the wake of the financial crisis.[4]

Since the marketplace is ever-changing, which in turn creates the development of complex financial products, the need for a uniform fiduciary standard is essential so that customers can be certain that their interests are protected no matter which type of industry professional recommends the purchase of an investment.

II. INVESTMENT ADVISERS VS. BROKER-DEALERS

There are two primary types of professionals that investors seek for advice and services: investment advisers and broker-dealers.[5] Although the two are nearly identical in that they provide customized financial advice to customers, they are currently regulated by separate securities acts and adhere to different standards of conduct.[6] In recent years, a hybrid model has emerged whereby financial professionals are registered as both brokers and investment advisers, resulting in dual registration.[7]

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[4] Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, Brodsky Family Lecture at Northwestern University School of Law (Nov. 9, 2010), *available at* http://www.sec.gov/news/speech/2010/spch110910mls.htm.

[5] Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 701 (2010).

[6] *Id.* at 701–02.

[7] *See* Dan LeGaye, *Dual Registration and FINRA Supervision*, PRAC. COMPLIANCE & RISK MGMT. FOR THE SEC. INDUSTRY 17 (May–June 2010), *available at* http://www.legayelaw.com/file/201005%20Article%20-%20Dual%20Registration.pdf (noting the supervisory issues relating to dual registration); *see also* U.S. SEC. & EXCH. COMM'N STAFF, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS iii (2011) [hereinafter STAFF STUDY], *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf ("Approximately 5% of Commission-registered investment advisers are also registered as broker-dealers, and . . . [a]pproximately 18% of

A. *Investment Advisers*

As of May 2012, there were more than 12,600 investment advisers registered with the SEC with nearly $50 trillion in assets under management.[8] "This represents a 9% increase in the number of advisers registered with the [SEC] since July 2011."[9] The SEC, under the Investment Advisers Act of 1940 ("Advisers Act"), regulates investment advisers.[10] The Advisers Act defines an "investment adviser" as

> 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.[11]

Under the Advisers Act, investment advisers are held to a "fiduciary" standard of care.[12] The Supreme Court's decision in *SEC v. Capital Gains Research Bureau, Inc.*,[13] is the most commonly cited source for the investment adviser fiduciary duty, wherein the Court held that an investment adviser has a fiduciary duty under the Advisers Act.[14] The SEC has recognized that "[i]t is not entirely clear whether the federal fiduciary duty established by the Court in *Capital Gains* is an example of judge-made common law, an interpretation of the Section 206 of the Advisers Act."[15] Nonetheless, the SEC has confirmed that "[t]here is no doubt, however, that an investment adviser is subject to the federal fiduciary duty."[16] Further, the SEC has

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FINRA-registered broker-dealers also are registered as investment advisers with the Commission or a state.").

[8] Luis A. Aguilar, Comm'r, Sec. & Exch. Comm'n, Advocating for Greater Federal and State Securities Regulatory Cooperation and Collaboration (May 7, 2012), *available at* http://www.sec.gov/news/speech/2012/spch050712laa.htm.

[9] *Id.*

[10] *See* 15 U.S.C. §§ 80b–1 to –21 (2012).

[11] § 80b–2(a)(11).

[12] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191–92 (1963).

[13] *Id.* at 180.

[14] *Id.* at 191–92 (noting other courts have found that Congress recognized that an investment advisor is a fiduciary with "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients").

[15] Memorandum from the Investor as Purchaser Subcomm. 3–4 (Feb. 15, 2010) [hereinafter Memorandum], *available at* http://www.sec.gov/spotlight/invadvcomm/iacmemofiduciaryduty.pdf.

[16] *Id.* at 4.

recognized that the fiduciary duty standard includes the duties of loyalty and care, which require investment advisers to put the interests of clients ahead of their own and to disclose or eliminate material conflicts of interest.[17]

B. Broker-Dealers

The Financial Industry Regulatory Authority (FINRA) oversees approximately 4,245 brokerage firms, 162,230 branch offices, and 633,150 registered-representatives.[18] The Securities Exchange Act of 1934 ("Exchange Act") regulates the business activities of broker-dealers.[19] The Exchange Act defines "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others"[20] and "dealer" to mean "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[21] Although the SEC has authority to adopt federal standards of competence,[22] the specific rules applicable to the broker-dealer profession are proscribed and enforced by FINRA.[23]

Since broker-dealers are generally excluded from the Advisers Act, they are not subject to a federal "fiduciary" standard of care.[24] Instead, and in the absence of a higher

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[17] *See* STAFF STUDY, *supra* note 7, at 22.

[18] *About the Financial Industry Regulatory Authority*, FINRA, http://www.finra.org/AboutFINRA (last visited Aug. 1, 2013); *see* STAFF STUDY, *supra* note 7 ("The Commission and FINRA oversee approximately 5,100 broker-dealers. As of the end of 2009, FINRA-registered broker-dealers held over 109 million retail and institutional accounts.").

[19] *See generally* Securities Exchange Act of 1934, Pub. L. No. 73-291, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a–78pp (2012)).

[20] 15 U.S.C. § 78c(a)(4)(A).

[21] *Id.* § 78c(a)(5)(A).

[22] Barbara Black, *How To Improve Retail Investor Protection After the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 13 U. PA. J. BUS. L. 59, 63 (2010) (citing 15 U.S.C. § 78o(b)(7), (c)(2)(D)).

[23] *See Get to Know Us*, FINRA, http://www.finra.org/web/groups/corporate/@corp/@about/documents/corporate/p118667.pdf (last visited Aug. 1, 2013) (explaining that part of FINRA's duties are "writing and enforcing rules governing the activities of nearly 4,400 securities firms with approximately 630,000 brokers"); *see also* Black, *supra* note 22, at 63.

[24] *See* 15 U.S.C. § 80b-2(a)(11)(C) (excluding any broker or dealer whose services are solely incidental to the conduct of his business as a broker or dealer and who does not receive any compensation for such services); *see also* Memorandum, *supra* note 15, at 5–6 ("The broker [dealer] exclusion [to the Advisers Act] is available if

standard imposed by case law, broker-dealers are held to a "suitability" standard of care under FINRA Rules. FINRA rules require broker-dealers to deal fairly and honestly with customers in accordance with industry standards, to recommend only "suitable" investments, and to seek the best execution for customers' orders.[25] Newly adopted FINRA Rule 2111 sets forth the "suitability" standard of care as follows:

> (a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.
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> (b) A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.[26]

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two conditions are satisfied: (1) no special compensation is received and (2) the advice is solely incidental to the broker's brokerage activities.").

[25] *See* FINRA Rule 2111, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859; FINRA Rule 5310, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10455; *see also* NASD Rule 2310, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638 (superseded by FINRA Rule 2111).

[26] FINRA Rule 2111. This rule was introduced with the filing of SR-FINRA-2010-039, which was approved by the SEC and effective as of July 9, 2012. *Id.* Prior to July 9, 2012, NASD Rule 2310, Recommendations to Customers (Suitability), governed broker-dealers' "suitability" standard of care. *See* NASD Rule 2310.

Although FINRA Rule 2111 recognizes that broker-dealers' duties to the customer are not limited to the point of purchase of investments, the "suitability" standard is less than the standard of care afforded by a fiduciary standard.[27]

III. THE DIFFERENCE BETWEEN BROKERS AND INVESTMENT ADVISERS IS UNCLEAR TO THE PUBLIC

In 2008, the SEC commissioned the RAND Corporation to determine the effectiveness of existing regulations for brokers and investment advisers.[28] The RAND report acknowledged: "In recent years, the evolution of the financial service industry has blurred traditional distinctions between broker-dealers and investment advisers and made it difficult to design appropriate regulatory schemes for their professional services."[29] The report indicated that many investors "do not understand key distinctions between investment advisers and broker-dealers—their duties, the titles they use, the firms for which they work, or the services they offer."[30] The survey results demonstrated that 63% of investors believe brokers provide advice about securities as part of their regular business; 51% of investors believe brokers recommend specific investments; 42% of investors believe brokers are required by law to act in the client's best interest, i.e., that brokers owe their customers a fiduciary duty; and 58% of investors believe brokers are required by law to disclose conflicts of interest.[31]

Obvious factors contributing to investor confusion are the "[m]arketplace changes that have resulted in investment advisers and broker-dealers offering similar services."[32]

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[27] *See* FINRA, Regulatory Notice 12–25, Suitability: Additional Guidance on FINRA's New Suitability Rule, at 6–7 (May 2012), http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p126431.pdf (noting that recommendations to hold securities, maintain or change investment strategies, or buy or sell securities does not create an ongoing obligation to monitor and make additional recommendations).

[28] ANGELA A. HUNG ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS iii (2008), http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf. RAND is a "nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world." *Id.* at ii.

[29] *Id.* at iii.

[30] *Id.* at 112–13.

[31] *Id.* at 89.

[32] *Id.* at 20.

Traditionally, the primary role of a broker-dealer was to execute securities transactions on the client's behalf.[33] Technological advances and the deregulation of commissions on securities transactions have impacted the profitability of this role.[34] In response, broker-dealers began to provide additional financial planning services and use titles such as "adviser" or "financial adviser" for their broker-dealer registered representatives.[35]

The following year, the Obama Administration released a plan for financial reform.[36] President Barack Obama stated it would be "a transformation on a scale not seen since the reforms that followed the Great Depression."[37] The plan, referred to as the "White Paper,"[38] sought to end the financial crisis and "restore confidence in the integrity of our financial system."[39] The White Paper acknowledged that the government could have done more to prevent many of the problems that contributed or resulted from the 2008 financial crisis.[40] In response, the White Paper laid out five reforms through which the administration sought to: (1) "[p]romote robust supervision and regulation of financial firms"; (2) "[e]stablish comprehensive supervision of financial markets"; (3) "[p]rotect consumers and investors from

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[33] Ross Jordan, Note, *Thinking Before Rulemaking: Why the SEC Should Think Twice Before Imposing a Uniform Fiduciary Standard on Broker-Dealers and Investment Advisors*, 50 U. LOUISVILLE L. REV. 491, 496 (2012) (citing Laby, *supra* note 5, at 423–24).

[34] *Id.*

[35] *See id.* at 496–97 (citing Tamar Frankel, *Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers* 10–11 (Bos. Univ. Sch. of Law, Working Paper No. 09-36, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1446750 (discussing the expanded list of services offered by many broker-dealers)); Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 BUS. LAW. 395, 404 (2010); *see also* Laby, *supra* note 5, at 734 ("Today, advances in technology have reduced the time and cost to process trades. As a result, the advice component of brokerage business has eclipsed transaction execution in importance.").

[36] Press Release, Office of the Press Sec'y, Remarks by the President on 21st Century Fin. Regulatory Reform (June 17, 2009) (on file with author).

[37] *Id.*

[38] Press Release, Office of the Press Sec'y, President Obama To Announce Comprehensive Plan for Regulatory Reform (June 17, 2009) (on file with author); U.S. DEP'T OF THE TREASURY, FIN. REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009), *available at* http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf [hereinafter WHITE PAPER].

[39] WHITE PAPER, *supra* note 38, at 2.

[40] *Id.*

financial abuse"; (4) "[p]rovide the government with the tools it needs to manage financial crises"; and (5) "[r]aise international regulatory standards and improve international cooperation."[41]

The White Paper was consistent with the RAND report and cited confusion among investors regarding the disparity between regulations governing broker-dealers and investment advisers.[42] The White Paper noted, "the legal distinction between the two is no longer meaningful. Retail customers repose the same degree of trust in their brokers as they do in investment advisers, but the legal responsibilities of the intermediaries may not be the same."[43] In an effort to address the confusion, the White Paper recommended that Congress "empower the SEC to increase fairness for investors" by "[e]stablish[ing] a fiduciary duty for broker-dealers offering investment advice and harmonize the regulation of investment advisers and broker-dealers."[44] The White Paper further emphasized:

> Standards of care for all broker-dealers when providing investment advice about securities to retail investors should be raised to the fiduciary standard to align the legal framework with investment advisers. In addition, the SEC should be empowered to examine and ban forms of compensation that encourage intermediaries to put investors into products that are profitable to the intermediary, but are not in the investors' best interest.[45]

The White Paper "formed the basis of the broad-based legislative review of financial services regulation that culminated in the Dodd-Frank [Wall Street Reform and Consumer Protection Act]."[46]

Following the publication of the RAND report and White Paper, regulators recognized the need to hold broker-dealers to the same standard of conduct as investment advisers. Mary Schapiro told participants at a Securities Industry and Financial Markets Association ("SIFMA") conference: "I believe that

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[41] *Id.* at 3–4.
[42] *Id.* at 71.
[43] *Id.*
[44] *Id.*
[45] *Id.* at 71–72.
[46] MERCER BULLARD, AARP PUBLIC POLICY INSTITUTE, PROTECTING INVESTORS—ESTABLISHING THE SEC FIDUCIARY DUTY STANDARD 3 (2011), *available at* http://financialservices.house.gov/uploadedfiles/091311aarpreport.pdf.

broker-dealers and investment advisers providing the same services, especially to retail investors, should meet that same high fiduciary standard . . . ."[47]

IV. DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

On July 21, 2010, a little more than a year after the White Paper was published, the Dodd-Frank Wall Street Reform and Consumer Protection Act[48] was signed into law with the mission "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[49] Dodd-Frank recognized investors' confusion and lack of confidence in the financial system by enacting section 913, *Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers*. Section 913 required the SEC to conduct a study to evaluate:

> (1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and
> (2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.[50]

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[47] Ronald D. Orol, *SEC: Broker-Dealers Should Be Held to Fiduciary Standard*, MARKETWATCH, May 6, 2010, http://articles.marketwatch.com/2010-05-06/economy/30747556_1_dealers-bank-reform-schapiro.

[48] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), *available at* http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

[49] *Id.*

[50] *Id.* § 913(b)(1).

Section 913 required the SEC to conduct a study examining existing standards of care for broker-dealers and investment advisers and to evaluate whether imposing a fiduciary standard on broker-dealers would ensure that investors are receiving appropriate and tailored investment advice from broker-dealers.[51]

V. SEC CONCLUSIONS

On January 22, 2011, the SEC fulfilled the mandate under section 913 of the Dodd-Frank Act by releasing its *Study Recommending a Uniform Fiduciary Standard of Conduct for Broker-Dealers and Investment Advisers* ("Staff Study").[52] As is evidenced from the title of the Staff Study, "[t]he overarching recommendation in the [Staff] Study is that the SEC should adopt a uniform fiduciary standard for investment advisers and broker-dealers."[53] Specifically, the Staff Study provided:

> Consistent with Congress's grant of authority in Section 913, the Staff recommends the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers under Advisers Act Sections 206(1) and (2). In particular, the Staff recommends that the Commission exercise its rulemaking authority under Dodd-Frank Act Section 913(g), which permits the Commission to promulgate rules to provide that:
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> > the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule

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[51] Jordan, *supra* note 33, at 491–92; *see* § 913(c)(5) (amending the Exchange Act and the Advisers Act to grant the SEC the authority to establish a fiduciary duty for broker-dealers "when providing personalized investment advice and recommendations about securities to retail customers").

[52] Jordan, *supra* note 33, at 499; Press Release, Sec. & Exchange Comm'n, SEC Releases Staff Study Recommending a Uniform Fiduciary Standard of Conduct for Broker-Dealers and Investment Advisers (Jan. 22, 2011) (on file with author); STAFF STUDY, *supra* note 7, at ii.

[53] Jordan, *supra* note 33, at 499.

> provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.[54]

In conducting the Study, the Staff met with interested parties, representatives of the financial services industry, state securities regulators, the North American Securities Administrator Association ("NASAA"), and FINRA.[55] Additionally, the Staff reviewed over 3,500 comment letters many of which stated, inter alia, that investors are confused about the differences between investment advisers and broker-dealers and the standards of conduct applicable to each.[56] In response, the Staff Study recommended the implementation of a uniform fiduciary duty to "increase investor protection and decrease investor confusion in the most practicable, least burdensome way for investors, broker-dealers and investment advisers."[57]

The Staff Study identified key components of a uniform fiduciary duty standard as being the duties of loyalty and care.[58] The Staff Study recommended that, in implementing a uniform fiduciary standard, the SEC "should engage in rulemaking and/or issue interpretive guidance addressing the[se] components."[59] Specifically, the Staff Study noted that the duty of loyalty requires eliminating and/or disclosing conflicts of interest and recommended that the SEC "prohibit certain conflicts and facilitate the provision of uniform, simple and clear disclosures to retail investors about the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest."[60] As for the duty of care, the Staff Study

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[54] STAFF STUDY, *supra* note 7, at v–vi (quoting Dodd-Frank Wall Street Reform and Consumer Protection Act § 913(g)); Jordan, *supra* note 33, at 499.

[55] STAFF STUDY, *supra* note 7, at ii; Jordan, *supra* note 33, at 499.

[56] STAFF STUDY, *supra* note 7, at v ("Many retail investors and investor advocates submitted comments stating that retail investors do not understand the differences between investment advisers and broker-dealers or the standards of care applicable to broker-dealers and investment advisers. Many find the standards of care confusing, and are uncertain about the meaning of the various titles and designations used by investment advisers and broker-dealers. Many expect that both investment advisers and broker-dealers are obligated to act in the investors' best interests."); Jordan, *supra* note 33, at 499.

[57] STAFF STUDY, *supra* note 7, at v.

[58] *See id.* at vii.

[59] *Id.* at vi.

[60] *Id.* at vii. (As part of the disclosures required under the duty of loyalty, the Study recommended that the SEC consider: "which disclosures might be provided

recommended the SEC specify uniform standards for the standard of care owed to retail investors, including the basis for making recommendations to an investor."[61]

In addition to the duties of loyalty and care, the Staff Study recommended that the SEC "address through interpretative guidance and/or rule making how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading"; "engage in rulecmaking and/or issue interpretive guidance to explain what it means to provide 'personalized investment advice about securities' "; and consider "investor education outreach as an important complement to the uniform fiduciary standard."[62]

The SEC concluded that imposing a uniform fiduciary standard would provide the following benefits: heightened investor protection and awareness; flexibility to accommodate diverse business models and fee structures; preservation of investor choice; continued investor access to existing products, services, and service providers; continued duties under applicable law for investment advisers and broker-dealers; and receipt of investment advice that is in an investor's best interest.[63]

A. *SEC Commissioners Found Shortcomings in the Staff Study*

SEC commissioners, Kathleen L. Casey and Troy A. Paredes, found shortcomings in the Staff Study, stating:

> [T]he Study's pervasive shortcoming is that it fails to adequately justify its recommendation that the Commission embark on fundamentally changing the regulatory regime for broker-dealers and investment advisers providing personalized investment advice to retail investors[;]
>
> The Study recommends the adoption of a new uniform fiduciary duty standard and harmonization of two disparate regulatory regimes. But it does so without adequate articulation or substantiation of the problems that would purportedly be addressed via that regulation[;]

most effectively"; "the utility and feasibility of a summary relationship disclosure document"; and "whether rulemaking would be appropriate to prohibit certain conflicts, to require firms to mitigate conflicts through specific action, or to impose specific disclosure and consent requirements.").

[61] *Id.*

[62] *Id.*

[63] *Id.* at viii.

> The Study also does not adequately recognize the risk that its recommendations could adversely impact investors[;]
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> . . . .
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> . . . [W]e oppose the Study's release to Congress as drafted. We do not believe the Study fulfills the statutory mandate of Section 913 of the Dodd-Frank Act to evaluate the 'effectiveness of existing legal or regulatory standards of care' applicable to broker-dealers and investment advisers[;]
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> . . . .
>
> . . . [T]he practical consequences resulting from that confusion for those very investors have not been sufficiently studied or documented. Moreover, the Study does not address the possibility that the Study's own recommendations will not resolve or eliminate investor confusion and may in fact create new sources of confusion[;]
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> . . . The Study unduly discounts the risk that, as a result of the regulatory burdens imposed by the recommendations on financial professionals, investors may have fewer broker-dealers and investment advisers to choose from, may have access to fewer products and services, and may have to pay more for the services and advice they do receive[;]
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> . . . .
>
> . . . Regulation based on poorly-supported recommendations runs the risk of restricting retail investors' access to affordable personalized investment advice and the range of products and services they currently enjoy.[64]

In addition, Casey and Paredes observed that there is no statutory deadline for any follow-up rulemaking to the Staff Study, and additional research and analysis are needed before rules are proposed to determine:

> [I]nvestor returns (controlling for risk and investor characteristics such as age, income, and education) generated under the two existing regulatory regimes[;]
>
> Comparison of the security selections of financial professionals subject to the two existing regulatory regimes in an effort to gauge differences in the quality of advice or types of product recommendations as a function of the regulatory regimes[;]
>
> Surveys of investors to obtain a general overview of the characteristics of investors who invest through a broker-dealer

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[64] Kathleen L. Casey & Troy A. Paredes, Comm'rs, U.S. Sec. & Exch. Comm'n, Statement by SEC Commissioners: Statement Regarding Study on Investment Advisers and Broker-Dealers (Jan. 21, 2011), http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

as compared to those who invest on the basis of advice from an investment adviser and to develop an understanding of investor perceptions of the cost/benefit tradeoffs of each regulatory regime[;]

Consideration of evidence related to the ability of investors to bring claims against their financial professional under each regulatory regime, with a particular focus on dollar costs to the investor and the results when claims are brought.[65]

B. *Timetable for a Uniform Fiduciary Duty Remains Undetermined*

On April 9, 2012, the SEC announced the formation of a new Investor Advisory Committee.[66] The purpose of the Investor Advisory Committee is "to advise the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, and on initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace."[67] Currently, the SEC's website reflects that the rule implementation timetable has been extended and remains undetermined.[68]

C. *The Arguments for and Against a Uniform Fiduciary Duty Standard*

While both sides generally agree that *some* form of a uniform fiduciary duty should be imposed,[69] positions are split on how the standard imposed should be defined, how far it should reach in relation to the standard currently owed by investment advisers, and the extent to which an equivalent standard would benefit or

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[65] *Id.*

[66] Press Release, Sec. & Exchange Comm'n, SEC Announces Members of New Investor Advisory Committee (April 9, 2012) (on file with author).

[67] *Id.*

[68] *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Pending Action*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml (last modified July 10, 2013).

[69] STAFF STUDY, *supra* note 7, at 107 ("Many commenters supported a uniform standard of conduct in some form for investment advisers and broker-dealers providing personalized investment advice about securities to retail customers. These commenters include investors' advocates, trade groups, state regulators, government officials, a self-regulatory organization [(FINRA)], industry representatives (including investment advisers, broker-dealers, and dually registered firms), coalition groups, academics, investors, and other individuals.").

harm those it is intended to protect.[70] With positions divided between retail investors and investor-advocates on one side, and brokers, investment advisers, and insurers on the other,[71] the case for and against imposing a uniform standard of fiduciary care for financial professionals has gained momentum.

1. Retail Investors and Investor Advocates Argue that a Uniform Fiduciary Duty Will Fuel Investor Protection and Close the Gap on Inconsistent Regulation of Financial Professionals

For retail investors and investor-advocates, the argument is simple: imposing a uniform fiduciary duty for brokers and investment advisers will make it easier to understand the obligations owed by trusted financial professionals, regardless of the hat they wear at the time of sale.[72] While it used to be easy to understand the difference between brokers and investment advisers acting in their traditional roles, the digital age, the rise of discount brokerages, and the emergence of one-stop-shops have changed what used to be separate and distinct roles into hybrid roles with significant overlap.[73] As a result, it has become difficult to distinguish financial professionals acting in the broker role from financial professionals acting in the investment adviser role—even for those with specialized knowledge of the industry.[74]

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[70] *See* Bonnie M. Treichel, Note, *The Quest for Financial Regulatory Reform: Will a Uniform Fiduciary Standard Guide the Way?*, 4 J. BUS., ENTREPRENEURSHIP & L. 151, 171–74 (2010).

[71] *See id.* (discussing the arguments put forth for and against a uniform fiduciary duty).

[72] *Id.* at 171 ("[A] uniform fiduciary standard will provide a more understandable system in which investors who seek to impose liability on their financial providers will not be confused as to the applicable standard [of care]."); *see* STAFF STUDY, *supra* note 7, at 101 ("Therefore, in light of this confusion and lack of understanding, it is important that retail investors be protected uniformly when receiving personalized investment advice or recommendations about securities regardless of whether they choose to work with an investment adviser or a broker-dealer.").

[73] *See* Treichel, *supra* note 70, at 160; *see also* STAFF STUDY, *supra* note 7, at 99 (noting RAND's conclusions that over the last few decades the financial services market has become more complex due to "market demands for new products and services and the regulatory environment").

[74] *See id.* (stating how providing increasingly similar services confuses the retail investor).

Since retail investors often lack specialized knowledge of the industry, they are likely to view the role of a financial professional as a financial professional, instead of as a financial professional acting as a broker or financial adviser.[75] With roles easily confused, investors are unlikely to understand that the role their financial professional is acting in will determine whether they are owed continuing obligations from an investment adviser or point of sale obligations from a broker performing the same function.[76] A uniform fiduciary duty for financial professionals will remove much of investors' confusion by the different outcomes when investors bring claims against brokers and investment advisers for breach of their professional obligations.[77]

In addition, investor advocates note the added benefit of requiring brokers to disclose conflicts of interest they might not otherwise disclose under the existing suitability standard as a significant benefit of a uniform fiduciary duty.[78] Under the status quo, suitability requires brokers to ensure the products they sell are suitable to the needs of clients and their individual risk tolerances at the time of sale.[79] As such, it does not require disclosure of all material conflicts of interest inherent in the sale itself, such as when the broker knows the broker-dealer is betting against the product being sold or when a broker's interest in higher-commission products conflicts with the client's interest in

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[75] *See* STAFF STUDY, *supra* note 7, at 97–99 (discussing the results of an investor survey that found investors did not understand the difference between investment advisers and broker-dealers but assumed both acted in the investor's best interests). Meanwhile,

> Americans seek investment advice, products, and services to help achieve a variety of goals, such as retirement planning, estate and insurance planning, educational needs, and the operation of small businesses. Baby boomers control roughly $13 trillion in household investable assets, or over 50 percent of total U.S. household investment assets, and nearly one in every six Americans will be 65 or older by the year 2020.

Id. at 93–94.

[76] *See id.* at i (stating that investors do not understand that investment advisors and broker-dealers are subject to different legal obligations and standards of care).

[77] *See id.* at 107 (recommending a uniform fiduciary standard because investors "should not have to parse the title on a business card or other information to assess whether the professional has their best interests at heart").

[78] *See* Treichel, *supra* note 70, at 170.

[79] *See id.* at 157 (describing how under the suitability standard, reasonable efforts must be made to assure that a recommendation comports with a customer's objective and financial status).

higher-return, lower commission products.[80] Adhering to a standard of care equal to that owed by investment advisers would require brokers to place the interests of investors ahead of their own and to disclose conflicts of interest that might not otherwise be disclosed.[81]

On the regulatory front, Congress and investor advocates note that a uniform standard will close the gap on inconsistent regulation of brokers and investment advisers, making the regulatory framework for financial professionals easier to enforce than it is under the status quo.[82] With brokers held to a lesser suitability standard while investment advisers are held to higher fiduciary standard, and brokers primarily regulated by FINRA while investment advisers are regulated by the SEC, regulation is inconsistent at best and inadequate in fact. The state of regulation is best seen in the reality that brokers "are examined [for compliance] by either FINRA or the SEC at least once a year," while investment advisers "are generally only examined by the SEC once every decade."[83] With compliance examination occurring more often for brokers than investment advisers, imposing a uniform fiduciary duty for financial professionals will bridge the gap of inconsistent regulation of brokers and investment advisers as trusted financial professionals, making the regulatory framework for financial professionals easier to enforce throughout the financial industry.

2. Brokers and Insurers Argue that a Uniform Fiduciary Duty Will Force the Overhaul of Existing Business Models, Will Create Costs Shifted to Retail Investors, and Will Force Ad Hoc Responses Proponents Failed To Consider

Wall Street argues that adhering to a uniform fiduciary duty is not so simple for brokers and insurers, whose business models will be affected by a higher standard of care.[84] It argues that business models will change, creating costs to be shifted to retail

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[80] *See id.* at 170 n.110 (explaining that certain investments will result in higher commission levels than others for brokers working for a brokerage firm having its own products to sell).

[81] *See id.* at 170.

[82] *See* Bullard, *supra* note 46, at 9 (discussing Congress's intent to "harmonize" the enforcement of rules applicable to broker-dealers and investment advisers).

[83] Treichel, *supra* note 70, at 166.

[84] *See id.* at 173–74 (arguing that a universal fiduciary standard will make it impossible to conduct business as usual).

investors in the form of higher fees and reduced competition.[85] Broker-dealers also argue that requiring a higher standard will require ad hoc rule making by the SEC, will necessitate the consolidation of enforcement under a single SRO, and will open the doors to legal challenges for failure to properly explore the compound effects of a higher standard of care on industry stakeholders.[86]

Opponents of the uniform fiduciary standard claim that this will lead to an increase in the costs of doing business throughout the financial industry.[87] For example, broker-dealers will need to study whether existing fee structures comply with a fiduciary standard of care, will increase the costs of training to comply with fiduciary obligations, and will increase the costs of compliance.[88] Where firms can afford the costs of compliance, costs will shift to consumers in the form of higher fees.[89] Where firms cannot afford the costs of compliance, costs will shift nonetheless, as the loss of less-established firms forces the flight to more-established, higher fee firms.[90] Insurers argue that their business models will be affected as well.[91] With existing business models built around the sale of variable annuities, requiring adherence to a fiduciary standard in the offering and sale of securities will require adherence to the same standard by insurance professionals, increasing the costs of offering variable rate annuities and traditional insurance products to offset the cost of compliance.[92]

As a reverberating theme, consumers will carry the increase in costs—whether or not they receive the benefit of those services received—rather than the firms that realize them.[93] In short,

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[85] *See id.*

[86] *Id.* at 172–75; ASS'N FOR ADVANCED LIFE UNDERWRITING (AALU), MORE ECONOMIC AND COST-BENEFIT ANALYSIS TO BE REQUIRED IN SEC RULEMAKINGS (May 23, 2012), http://aaluwr.org/displayreport.php?wrID=2839.

[87] *See* Treichel, *supra* note 70, at 173–74.

[88] *See id.* at 173 (noting that broker-dealers will have to change their line of work to comply with the new standards).

[89] *See id.* (complying with a new fiduciary standard will be a great expense that the investor will bear "in some form or another").

[90] *See id.* (arguing that the expense to comply with the new fiduciary standards will force broker-dealer firms to shut down, thereby burdening retail investors with the task of finding new financial institutions).

[91] *Id.* at 173–74.

[92] *Id.* at 174.

[93] *See id.*

while requiring brokers and insurers to adhere to a higher standard of care, the costs of complying with such a standard will shift to those it is intended to protect, that is, to consumers of brokerage, investment advisory, and variable rate annuity products, as well as to those that will never see the benefit, that is, to consumers of traditional insurance products.[94] If Wall Street's arguments were true, an exodus of broker-dealers from states that already impose a fiduciary duty would have occurred.

VI. THE DEPARTMENT OF LABOR'S FIDUCIARY STANDARD

At the same time the federal government and SEC sought to propose a new fiduciary duty, the Department of Labor ("DOL") set out to amend its thirty-five-year-old fiduciary rule.[95] On October 22, 2010, approximately three months after Dodd-Frank was signed into law, the Department of Labor sought to amend a rule under the Employee Retirement Income Security Act ("ERISA") "that, upon adoption, would protect beneficiaries of pension plans and individual retirement accounts by more broadly defining the circumstances under which a person is considered to be a 'fiduciary' by reason of giving investment advice to an employee benefit plan or a plan's participants."[96] The proposed rule responded to significant changes in the financial industry that increased the types and complexity of investment products and services available.[97] Its purpose was "to protect participants from conflicts of interest and self-dealing by giving a broader and clearer understanding of when persons providing such advice are subject to ERISA's fiduciary standards."[98]

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[94] *See id.* at 172–74.

[95] Press Release, U.S. Dep't of Labor, US Labor Department Proposes Rule Defining 'Fiduciaries' of Employee Benefit Plans (October 21, 2010) (on file with U.S. Dep't of Labor).

[96] Definition of the Term "Fiduciary," 75 Fed. Reg. 65,263, 65,263 (proposed Oct. 22, 2010) (to be codified at 29 C.F.R. pt. 2510).

[97] *Id.* at 65,264.

[98] *Id.*

One year later, on September 19, 2011, the DOL withdrew its proposed fiduciary rule[99] after criticism from the financial industry and lawmakers.[100] Opponents argued that the proposed rule was too broad and lacked a sufficient cost-benefit analysis.[101] In response, the DOL announced its plan to re-propose a new fiduciary rule in early 2012 after a cost benefit/regulatory impact analysis.[102] In early 2012, the DOL expanded its "regulatory impact analysis" to assess what kind of impact the DOL's re-proposed fiduciary rule would have on the financial industry, which in turn postponed re-proposal to the summer of 2012.[103] Currently, the DOL is in the process of re-proposing a new fiduciary rule.

According to Phyllis Borzi, Assistant Secretary of the Department of Labor's Employee Benefit's Security Administration,

> [e]ven if the SEC and DOL collaborated on the same definition of fiduciary, it wouldn't really get [the brokerage industry] what they want, which is a single set of rules, because even if the

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[99] Margaret Collins, *Labor Department Will Delay Its Fiduciary Rule, Borzi Says*, BLOOMBERG BUSINESSWEEK, Sept. 19, 2011, http://www.businessweek.com/news/2011-09-19/labor-department-will-delay-its-fiduciary-rule-borzi-says.html.

[100] Mark Schoeff Jr., *INsider: Timeline for Fiduciary Rule Slip-Sliding Away*, INVESTMENTNEWS, Jan. 9, 2012, http://www.investmentnews.com/article/20120109/FREE/120109950 [hereinafter *INsider*]; Mark Schoeff Jr., *Cost Analysis Could End DOL Proposal*, INVESTMENTNEWS, Apr. 29, 2012, http://www.investmentnews.com/article/20120429/REG/304299973 [hereinafter *Cost Analysis*].

[101] *Cost Analysis*, *supra* note 100 ("Skeptics contend that the initial rule that the Labor Department proposed in 2010 would subject brokers making individual retirement account sales to a fiduciary duty under federal retirement law for the first time, potentially pushing them out of the IRA market."); *INsider*, *supra* note 100; Jessica Toonkel, *Labor Department Not Deterred in Fiduciary Rule Proposal*, REUTERS, Mar. 19, 2012, http://www.reuters.com/article/2012/03/19/us-labordept-fiduciary-idUSBRE82I10620120319.

[102] *INsider*, *supra* note 100.

[103] Melanie Waddell, *DOL Deadline on Fiduciary IRA Request Set for Feb. 24*, ADVISORONE, Feb. 16, 2012, http://www.advisorone.com/2012/02/16/dol-deadline-on-fiduciary-ira-request-set-for-feb; *see* Mark Schoeff Jr., *Looming Election Slams Brakes on Fiduciary Regs*, INVESTMENTNEWS, May 27, 2012, http://www.investmentnews.com/article/20120527/REG/305279994 (re-proposing the rule "as early as this summer"); *see also* Melanie Waddell, *DOL's Borzi: Retirement Fiduciary Re-Proposal Out Early Next Year*, ADVISORONE, Oct. 25, 2011, http://www.advisorone.com/2011/10/25/dols-borzi-retirement-fiduciary-re-proposal-out-ea (re-proposing the rule "shortly after the first of the year").

> same people were defined as fiduciaries, the rules that they would be subject to as fiduciaries in the two different statutory schemes would be so very different.[104]

Nonetheless, Borzi emphasized that while the two rules "can't be identical"—"they can be consistent and compatible."[105]

VII. PRACTICAL IMPLICATIONS

When new customers walk into a brokerage firm's lobby for the first time, the customers meet a broker and sit down in an office for a discussion of their specific needs and goals. After some conversation, if the customers decide to do business with the broker, the customers will hand over substantial portions of their savings from their life's work, trusting that the broker will handle their funds appropriately. When this occurs, the broker-dealer becomes a trusted agent of the customers. Specifically, the customers have placed their trust and confidence in the brokerage firm's ability to adequately manage their money. At the moment the customers deliver all or a substantial portion of their net worth to a broker, they justifiably believe, and indeed are told, that they can trust that the broker will act as their fiduciary.

Customers that have suffered some type of wrongdoing are surprised when Wall Street quickly disclaims any duty owed, let alone a fiduciary duty, after litigation or arbitration has commenced. The post-dispute disclaimer of a duty owed to the customers is true in virtually all cases defended by broker-dealers. A broad based fiduciary duty would help curtail this Wall Street practice and help close the credibility gap between what is said to customers when their accounts are opened and what is argued to arbitrators after a dispute has arisen.

CONCLUSION

Today, the SEC and DOL control the fate of whether or not there will be a uniform fiduciary standard. The adoption of a uniform fiduciary duty requiring all broker-dealers to act in the best interests of their clients and make full and fair disclosures

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[104] Melanie Waddell, *Phyllis Borzi: The 2012 IA 25 Extended Profile*, ADVISORONE, May 16, 2012, (alteration in original), http://www.advisorone.com/2012/05/16/phyllis-borzi-the-2012-ia-25-extended-profile.

[105] *Id.*

would be a step in the right direction. A single broad-based uniform fiduciary standard would better serve investors by enhancing transparency and protecting the integrity of the marketplace. The time for a uniform fiduciary duty is now.