A "New" Fiduciary Duty for Stockbrokers?
Keeping the Dodd-Frank Rule Debate in Perspective

Robert N. Rapp[*]

I. INTRODUCTION

The securities industry is awaiting the conclusion of a study now underway by the U.S. Securities and Exchange Commission (SEC) which will in all likelihood lead to the adoption of a rule imposing a fiduciary duty on broker-dealers[1] who provide "personalized investment advice" to their retail customers. In the Dodd-Frank Wall Street Reform and Consumer Protection Act,[2] Congress addressed a widely perceived disparity in standards of conduct governing client relationships of investment advisers[3] on the one hand, and securities broker-dealers on the other, in regard to personalized investment advice provided by both. Section 913 of Dodd-Frank directs the SEC to evaluate the effectiveness of existing legal or regulatory standards of care for brokers,

---

[*] Robert N. Rapp, B.A., J.D., Case Western Reserve University; M.B.A., Cleveland State University, is a partner with Calfee, Halter & Griswold LLP, Cleveland, Ohio, where his practice concentration is financial market regulation and related litigation. He is the author of *Blue Sky Regulation* (2d ed., Matthew Bender & Co., Inc.), and is Adjunct Professor of Law at the Case Western Reserve University School of Law, where he teaches "Law, Theory and Practice in the Financial Markets."

The author gratefully acknowledges the assistance and contributions of Matthew J. Kucharson, associate with Calfee, Halter & Griswold LLP, in the final preparation of this paper.

[1] "Broker-dealer" means an intermediary engaged in activities as both securities broker and a dealer. The combined function is defined as "dealer" in section 2(12) of the Securities Exchange Act of 1934, 15 U.S.C. §78b(12) (2010), as follows:

> The term "dealer" means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.

[2] Pub. L. 111-203, 124 Stat. (codified in scattered sections of the United States Code) (hereinafter "Dodd-Frank").

[3] With certain exclusions, "investment adviser" is defined in section 202 of the Investment Advisers Act of 1940, 15 U.S.C. §80b-2 (2010) (the "Investment Advisers Act"), in pertinent part, as:

> [A]ny 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….

dealers, investment advisers, and persons associated with them, when providing personalized investment advice and recommendations to retail customers. From there, the SEC is expressly authorized to establish a "fiduciary duty for brokers and dealers"[4] when providing personalized investment advice to retail customers.[5]

The stated objective in establishing a fiduciary duty for broker-dealers is to match the standard of conduct applicable to investment advisers. That standard is said to be grounded in the Investment Advisers Act of 1940,[6] under which investment advisers meeting certain threshold criteria for assets under management are registered with, and regulated by, the SEC.[7] Although the Investment Advisers Act does not actually provide for any particular standard of conduct for investment advisers, the standard said to arise under it, and which is offered as setting investment advisers apart from broker-dealers, is a "fiduciary" duty that is generally characterized today as the duty to act always in a client's "best interest."

On the other hand, today the duty of a broker-dealer in making investment recommendations is most often described only in terms of the "suitability" of investment recommendations. In the Investment Advisers Act, broker-dealers are expressly excluded from the definition of "investment adviser" when their performance of advisory services is solely

---

[4] *Id.,* § 913(g).

[5] *Id.,* § 913(f).

A "retail customer" is a natural person who: (a) receives personalized investment advice about securities from a broker, dealer or investment adviser; and (b) uses such advice primarily for personal, family or household purposes. *See* Dodd-Frank § 913(a).

[6] 15 U.S.C. §80b-1, e*t seq.* (2010) (the "Investment Advisers Act").

[7] Dodd-Frank amended the Investment Advisers Act, such that, effective July 21, 2011, the assets under management threshold for SEC registration of investment advisers becomes $100 million.[7] Although certain smaller advisers may elect to register with the SEC, most advisers under the $100 million threshold will be regulated under state securities laws. Nothing in Dodd-Frank addresses the standard of conduct applicable to investment advisers arising under state law, although the general antifraud provisions of the Investment Advisers Act apply to acts and conduct of any investment adviser carried out by use of the jurisdictional means, regardless of federal or state registration.

incidental to the conduct of business as a broker or dealer and they receive no special compensation.[8] This exclusion is generally seen as the foundation for whatever perceived differences exist in the legal duties of broker-dealers and investment advisers owed to their respective customers and clients. Given the current initiative toward a unified standard, it is not surprising that a further element of the Dodd-Frank mandated study calls for the SEC to consider the potential impact of eliminating the broker-dealer exclusion from the definition of investment adviser.[9]

The broker-dealer "suitability" duty is perceived as at odds with the broader "fiduciary" duty by which investment advisers are said to be obliged always to place client interests ahead of their own --an affirmative duty to act in the best interests of their clients, and to serve them with undivided loyalty-- in rendering investment advice. However, as addressed further in this paper, the actual standard of conduct applicable to broker-dealers is not nearly so limited as the advocates of a unified fiduciary standard would make out. Moreover, articulating a workable "unified" standard is a more complex undertaking than might appear.

The path to a unified standard of conduct for broker-dealers and investment advisers in Dodd-Frank is somewhat convoluted. As set up in Dodd-Frank, the standard of conduct applicable to both broker-dealers and investment advisers would be unified by SEC rulemaking authority consistent with an amendment to the Investment Advisers Act. New section 211(g) ("Standard of Conduct")[10] was added, authorizing the SEC to promulgate rules establishing a

---

[8] 15 U.S.C. §80b-2(a)(11) (2010).

[9] *See* Dodd-Frank Act §913(b)(10).

The SEC is to study the matter in terms of the impact and potential benefits or harm to retail customers that could result from a change, and the number of additional entities and individuals that would be required to register under, or become subject to, the Investment Advisers Act.

[10] 15 U.S.C. §80b-11(g) (2010).

standard of conduct for *all brokers, dealers and investment advisers* "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."[11] New section 211(g) of the Investment Advisers Act is carried into the broker-dealer regulatory scheme under the Securities Exchange Act of 1934 (the "Exchange Act") with an amendment to Section 15 of the Exchange Act,[12] which now provides in pertinent part:

> Notwithstanding any other provision of this Act or the Investment Advisers Act of 1940, the Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act.[13]

Although the process is set in motion, adoption of a unified "fiduciary" standard by the SEC is not a foregone conclusion. As will be seen, there are a number of impediments to fashioning a workable unified standard, in addition to answering the baseline question whether one is needed at all. However, as evident in this recent statement by SEC Chairman Mary Schapiro, the energy behind it is unmistakable: "I have long advocated such a uniform fiduciary standard and I am pleased the legislation would provide us with the rulemaking authority necessary to implement it."[14] Moreover, the Dodd-Frank mandated study follows in the wake of a RAND Corporation study, commissioned by the SEC itself, which found that retail investors are today confused about the differences between investment advisers and broker-dealers --

---

[11] 15 U.S.C. § 80b-11(g)(1) (2010).

[12] 15 U.S.C. §78o (2000).

[13] Dodd-Frank Act § 913(k)(1).

[14] Mary L. Schapiro, Remarks at the National Conference of the Society of Corporate Secretaries and Governance Professionals (July 9, 2010), available at http://www.sec.gov/news/speech/2010/spch070910mls.htm.

particularly as to the legal duties owed to them with regard to the services and functions each performs.[15] Among other things, the Rand Report concluded that services and marketing by broker-dealers and investment advisers have become increasingly indistinguishable.[16]

On the assumption that there are meaningful gaps or shortcomings in the existing protection of broker-dealer customers, the stage is thus set for rulemaking by which broker-dealers would be deemed "fiduciaries" when making investment recommendations to their retail customers. However, given the fundamental "fiduciary" principles governing the conduct of broker-dealers and their representatives that are already well-established (and largely ignored in the current debate), it is not at all clear that the imposition of a perceptibly new, undefined or under-defined fiduciary duty on broker-dealers who make investment recommendations will advance the protection of their investor-customers to a higher level. It may in fact operate contrary to their best interests, as a one-size-fits-all universal "fiduciary" duty standard fails to take into account the nuances and realities of actual broker-customer account relationships when compared to relationships between investment advisers and their clients.

Seeds of uncertainty as this process moves forward have been planted by Dodd-Frank itself. Whatever unified standard of conduct applicable to broker-dealers and investment advisers

---

[15] RAND Corporation, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008) (the "RAND Report").

[16] RAND Report, Executive Summary, at xix. The Report noted, for example:

> We presented respondents with a list of services and obligations and asked them to indicate which items applied to investment advisers, brokers, financial advisors or consultants, or financial planners. Their responses indicate that they view financial advisors and financial consultants as being more similar to investment advisers than to brokers in terms of services and duties. However, regardless of the type of service (advisory or brokerage) received from the individual professional, the most commonly cited titles are generic titles, such as *advisor*, *financial advisor*, or *financial consultant*. Focus-group participants shed further light on this confusion when they commented that the interchangeable titles and "we do it all" advertisements made it difficult to discern broker-dealers from investment advisers.

in the conduct of their business is envisioned, Dodd-Frank at the same time assures as to broker-dealers:

> Nothing in this section [amended Exchange Act §15] shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.[17]

This statutory caveat stands in sharp contrast to what SEC Commissioner Luis Aguilar recently described as the defining characteristic of the fiduciary relationship between an investment adviser and its client. Speaking to investment adviser compliance professionals, Commissioner Aguilar characterized the investment adviser's duty as an "affirmative obligation that continues throughout the relationship between an adviser and client and controls all aspects of their dealings."[18] There is no way to harmonize the purely transactional view of the broker-dealer duty which arises out of an agency relationship with the on-going relationship duty of an investment adviser which, moreover, is normally defined by terms of an advisory contract. It is apparent that Congress has made actually defining and implementing a "unified" standard of conduct for both broker-dealers and investment advisers a much more complicated task. As discussed later in this paper, all of this comes in a context in which meaningful "fiduciary" duties and principles-based responsibilities of broker-dealers in their customer relationships are already well-established, and present a much more defined standard of conduct and structure than the high-toned "fiduciary" duty of investment advisers to which a new standard for brokers would aspire.

To be sure, the financial services world has changed. The role of a stockbroker, long characterized in terms of sales, evolved into something markedly different. Broker-dealer,

---

[17] Dodd-Frank §913(g)(1), now Securities Exchange Act of 1934 §15(b)(k)(1), 15 U.S.C. §78o(b)(k)(1) (2010).

[18] Aguilar, A Shared Responsibility: Preserving the Fiduciary Standard, IA Compliance Best Practices Summit 2010 (Mar. 26, 2010).

agents, representatives or account executives became "Financial Advisers," "Financial Consultants," or overall, "investment professionals." Over time, the brokerage industry shifted heavily to asset gathering, asset allocation, general financial and retirement planning, third party money management consulting, and to fee-based compensation structures and product offerings.[19] It is also true, as a the Rand Report confirmed, there is investor confusion about investment adviser and broker titles, and in distinguishing any significant differences in expected duties between them. But throughout this evolutionary period, fiduciary principles have always been applied to prevent a broker from acting adversely to the best interests of a customer, to deal fairly, and to require disclosures and other procedures designed to assure that customers make informed determinations with regard to their transactions.

Just ahead of Congressional passage of Dodd-Frank, Rep. Spencer Bachus, Ranking Member of the House Financial Services Committee, cautioned that, in considering any new rules regarding broker-dealers and investment advisers, it is critically important that the unique roles of different financial professionals, their distinct relationships with their customers, and the nature of services and disclosures they provide be fully examined and well understood.[20] Confused investor perceptions notwithstanding, brokers and investment advisers have unique roles and relationships. This is why there is an Investment Advisers Act in the first place, and why broker-dealers providing incidental advice were excluded from the definition of investment adviser. Those calling for a unified fiduciary standard applicable to broker-dealers and investment advisers must heed the Bachus message to fully understand the distinct relationships

[19] *See* Rapp, Rethinking Risky Investments for that Little Old Lady: A Realistic Role for Modern Portfolio Theory in Assessing Suitability Obligations of Stockbrokers, 24 *Ohio Northern L. Rev.* 189, 218 (1998).

[20] *Congressional Record*, June 30, 2010, at H5255.

between brokers and their customers on the one hand, and investment advisers and their clients on the other. The SEC cannot do otherwise.

With this in mind, and to keep the ongoing debate and whatever SEC conclusion on rulemaking is to come from the Dodd-Frank study in proper perspective, this paper examines the "new" fiduciary standard of conduct to which brokers would be held in comparison to the fiduciary principles-based duty that already govern their customer relationships. Focusing on the specific object of protection addressed in Dodd-Frank --the retail customer receiving information and advice about investments in a transactional setting-- there is ample basis on which to conclude that nothing will actually be gained through the imposition of a "new" duty stated in terms only of acting in a customer's "best interest." A new SEC rule setting some form of unified standard of conduct may be inevitable. However, such a rule must be informed by and entirely consistent with not only what is specifically addressed in Dodd-Frank, but also what already provides meaningful protection in a financial services environment in which broker-dealer customers rightly understand and expect that a trusted investment professional is in fact putting their best interests first when making investment recommendations. Searching for the parameters of such a rule, it is necessary first to look more closely at the Dodd-Frank approach to a unified standard of conduct, and then to the perceived divergent duties of investment advisers and broker-dealers which would be harmonized into a benchmark investment adviser "fiduciary" standard.

II. THE DODD-FRANK APPROACH TO A UNIFIED STANDARD OF CONDUCT

In Dodd-Frank, the foundation for a unified standard of conduct for broker-dealers and investment advisers is new section 211(g)(1) of the Investment Advisers Act,[21] which prescribes

[21] 15 U.S.C. §80b-11(g)(1) (2010).

SEC rulemaking authority for a unified standard. While expressly providing that the overarching standard of conduct for all brokers, dealers, and investment advisers shall be to "act in the best interest of the customer without regard to the financial or other interest" in providing investment advice. New section 211(g)(1) prescribes certain specific elements of any rulemaking. First, in accordance with such rules, "any material conflicts of interest shall be disclosed and may be consented to by the customer."[22] In this regard, Dodd-Frank directs the SEC to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest.[23]

Second, such rules must provide that the standard of conduct "shall be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of [the Investment Advisers Act] when providing personalized investment advice about securities."[24] Overall, section 206 of the Investment Advisers Act addresses "prohibited transactions" by an investment adviser. Subsections (1) and (2) of section 206 specifically are general antifraud provisions. "Prohibited transactions" under sections 206(1) and (2) consist of defrauding clients --the employment of any device, scheme, or artifice to defraud any client or prospective client, or fraudulent practices -- and any transaction, practice, or course of business by an investment adviser which operates as a fraud or deceit upon any client or prospective client. Nothing in either section 206(1) or (2) identifies any specific act or conduct deemed to be fraudulent, and thus prohibited.

---

[22] *Id.*

[23] Dodd-Frank §913(g)(1), now 15 U.S.C. §78o(l)(1) (2010).

[24] *Id.*

Third, as a caveat on the exercise of rulemaking authority, "the receipt of compensation based on commission or fees shall not, in and of itself, be considered a violation of such standard applied to a broker, dealer, or investment adviser."[25] That said, Dodd-Frank specifically directs the SEC to examine and, where appropriate, promulgate rules prohibiting or restricting "compensation schemes for brokers, dealers and investment advisers," as well as sales practices and conflicts of interest that the SEC "deems contrary to the public interest and the protection of investors."[26]

Specifically focusing on broker-dealers, Dodd-Frank prescribes certain additional elements of any SEC rulemaking. The first, dealing with disclosure of the range of products offered, provides that where a broker-dealer sells only proprietary or some other limited range of investment products, the SEC may by rule "require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer."[27] However, as an express caveat on this rulemaking authority, Dodd-Frank also makes clear that the sale of "only proprietary or other limited range of products" by a broker-dealer shall not in and of itself be considered a violation of the standard of conduct.[28]

Without question, the most significant qualification on the standard of conduct as it would be articulated and applied to broker-dealers and their registered representatives is that nothing in SEC rulemaking shall require either to have a continuing duty of care or loyalty to the customer after providing personalized investment advice.[29] With this qualification, the

---

[25] *Id.*

[26] *Id.*, now 15 U.S.C. §78o(l)(2) (2010).

[27] Dodd-Frank §913(g)(2), now 15 U.S.C. §78o(k)(2) (2010).

[28] *Id.*

[29] Dodd-Frank §913(g)(1), now 15 U.S.C. §78o(k)(1) (2010).

transactional focus of the intended standard of conduct as applied to broker-dealers is obvious, and is thus problematic in terms of a unified standard for both broker-dealers and investment advisers.

The broker-customer relationship cannot be defined in terms of an on-going contractual relationship like that of an investment adviser, in which the adviser affirmatively undertakes to advise, monitor or carry on portfolio management for a client.[30] To be sure, an on-going broker responsibility arises in a discretionary account relationship. This has never been an issue, although, as with investment advisers, the duty has never been well-defined. But these circumstances are increasingly rare today, as brokers focus instead on providing their clients seeking portfolio management a choice of recommended third-party money managers (vetted by their firms in the exercise of due diligence) suited to the profile of the customer, who are directly engaged by the customer to invest and manage the customer's portfolio. In virtually all cases, these money managers are registered investment advisers. This is the contemporary model of discretionary broker-customer relationships.

In sum, however, looking at the complete legislative construct, Dodd-Frank:

- Empowers the SEC to adopt rules that would require broker-dealers to comply with the standards of conduct applicable to investment advisers when providing personalized investment advice about securities to retail customers.

[30] It is true that relationships between investment advisers and their clients may be functionally like broker discretionary and non-discretionary account relationships. An investment adviser may be engaged only to render portfolio analysis and to advise on composition, asset allocation, or specific investment decisions to be made by the client. The investment adviser may also be engaged to manage the portfolio, and in that function to act under a limited power of attorney or trading authority granted by the client. There is, nevertheless, a fundamental difference. Investment advisers are *engaged to render advisory services*, however those services may be defined in the advisory contract, and pursuant to the terms of an advisory contract. Advisory contracts address all aspects of the adviser-client relationship, and are significantly regulated by section 205 of Investment Advisers Act, 15 U.S.C. §80b-5. To be sure, broker-dealer customers may, and in many instances must, execute a customer agreement. However, this agreement is far different from an advisory contract and, in practical terms, is addressed to the obligations of the customer in maintaining an account and entering into transactions. The two "agreements" function in entirely different ways.

- Empowers the SEC to adopt rules requiring broker-dealers to notify retail customers and obtain their acknowledgement or consent when the broker-dealer provides only a limited range of investment products.

- Directs the SEC to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest.

- Directs the SEC to examine and, where appropriate, promulgate rules prohibiting or restricting sales practices, conflicts of interest and compensation schemes for broker-dealers and investment advisers that the SEC deems contrary to the public interest and the protection of investors.[31]

Against this backdrop, and fully appreciating the nuanced elements of what Dodd-Frank has set in motion, a look at the perceived investment adviser benchmark duty follows below.

III. THE FIDUCIARY DUTY OF INVESTMENT ADVISERS

Conventional wisdom has long held that, by virtue of the personalized character of the services of investment advisers to their clients, and the potential for conflicts of interest between adviser and client which might, consciously or unconsciously, lead an investment adviser to render advice which is not disinterested, advisers owe a "fiduciary" duty to their clients. This duty, in simplest terms, means that the best interests of clients must be paramount --that the adviser must in all instances place the client's interests first in making any recommendation or rendering advice. The fiduciary duty of investment advisers is commonly attributed to the Investment Advisers Act, and the specialized regulatory scheme it imposes. In fact, the term "fiduciary duty" never appears in the Act.

The genesis of the distinct fiduciary duty of investment advisers recognized today is actually the 1963 decision of the U.S. Supreme Court in *SEC v. Capital Gains Research Bureau*,

[31] Note as well that Dodd-Frank amended the Securities Exchange Act of 1934 and the Investment Advisers Act to provide the SEC with authority to bring enforcement actions against broker-dealers or investment advisers with respect to personalized investment advice provided to retail customers using the standards of conduct applicable under either Act. *See* Dodd-Frank §913(h) (Harmonization of Enforcement).

Inc.,[32] in which the Court concluded that the broadly worded antifraud prohibition of the Investment Advisers Act, and congressional intent to eliminate conflicts of interest between advisers and clients,[33] reflected a recognition of the "delicate fiduciary nature of a investment advisory relationship, as well as a congressional intent to eliminate, or at least expose, all conflicts of interest…."[34] The issue before the Court in *Capital Gains Research* was whether, under the Investment Advisers Act, the SEC could obtain an injunction compelling a registered investment adviser to disclose to his clients a practice of purchasing shares of a security for his own account before recommending that security to his client for long term investment, and then immediately selling the shares at a profit upon the rise in the market price following the recommendation. The power to do so turned on whether the practice --known as "scalping"-- was deemed to operate as a fraud or deceit upon a client or prospective client within the meaning of section 206 of the Act.[35] The Court concluded that such conduct did amount to fraudulent or deceitful conduct under the Act, and that the SEC was entitled to enforce compliance with the Act by obtaining an injunction requiring the adviser to make full disclosure of the practice to his clients without the necessity of showing intent to injure and actual injury to clients. Justice Goldberg explained:

---

[32] 375 U.S. 180, 84 S. Ct. 275, 11 L. Ed. 2d 237 (1963).

[33] *See* S. Rep. No. 1775, 76th Cong. 3d Sess. 22 (1940). Speaking for the Court in *Capital Gains Research*, Justice Goldberg observed that the Committee Reports indicate a desire to preserve "the personalized character of the services of investment advisers," and to eliminate conflicts of interest between the investment adviser and the clients as safeguards both to "unsophisticated investors," and to "bona fide investment counsel." 375 U.S. at 192 (quoting the Senate Report, internal citations omitted).

[34] 375 U.S. at 192 (quoting 2 L. Loss, Securities Regulation 1412 (2d ed. 1961)).

[35] 15 U.S.C. § 80b-6 (2000). Section 206 provides in pertinent part:

> It shall be unlawful for any investment adviser, by use of the mails or any means instrumentality of interstate commerce, directly or indirectly: (1) to employ any device, scheme or artifice to defraud any client or prospective client; (2) to engage in any act, transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client….

> The statute, *in recognition of the adviser's fiduciary relationship to his clients,* requires that his advice be disinterested. To ensure this it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statute to confine its application to "dishonest" as opposed to "honest." As Dean Schulman said in discussing the nature of securities transactions, what is required is "a picture not simply of the show window, but of the entire store… not simply the truth in the statements volunteered, but disclosure." The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly reviewing his personal interests in these recommendations to his clients.[36]

The unique role of investment advisers among market intermediaries perceived at the time of the *Capital Gains Research* decision is evident in the Court's express recognition of testimony given by the president of the Investment Counsel Association of America in Senate hearings on the proposed legislation:

> [T]wo fundamental principles upon which the pioneers of this new profession undertook to meet the growing need for unbiased investment information and guidance were, first, that they would limit their efforts and activities to the study of investment problems from the investor's standpoint, not engaging in any other activity, such as security selling or brokerage, which might directly or indirectly bias their judgment; and second, that their remuneration for this work would consist solely of definite professional fees fully disclosed in advance.[37]

Against this backdrop, historical recognition of the fiduciary duty of an investment adviser is easily understood. The fact that the Investment Advisers Act exists as a separate element of the federal securities laws is a simple testament to the fact that the business of investment advisers was seen as being different from other market intermediaries, and that specialized regulation was needed. In *Capital Gains Research*, the Supreme Court needed to look only at clearly stated legislative intent:

---

[36] 375 U.S. at 201 (emphasis added).

[37] *See* 375 U.S. at 190 (quoting Hearings on S. 3580 before the Senate Committee on Banking and Currency, 76 Cong. 3d Sess., at 724).

> Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission… It is hereby declared that the national public interest and the interests of investors are adversely affected… (4) when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable advisers to relieve themselves of their fiduciary obligations to clients.[38]

Thus, since *Capital Gains Research,* it has been recognized as a matter of law that investment advisers owe their clients 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 [their] clients."[39] Although nowhere defined, in practice, and enforcement, this translated into the duty to:

- Make reasonable investment recommendations independent of outside influences, and fully disclosing all material conflicts of interest;[40]
- Select broker-dealers based on their ability to provide the best execution of trades for accounts where the adviser has authority to select the broker-dealer;[41]
- Make suitable recommendations based on a reasonable inquiry into a client's investment objectives, financial situation and other factors; [42]and, most prominently;
- Always place client interests ahead of their own.[43]

---

[38] 357 U.S. at 189 (quoting S. 3580).

In *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11(1979), the Supreme Court itself later underscored that the Investment Advisers Act "establishes federal fiduciary standards' to govern the conduct of investment advisers." and that "the Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations." *Id.,* at 17.

[39] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. at 194 (citations omitted).

[40] *Id.*, 191-92.

[41] *See* Kidder Peabody & Co., Inc., Investment Advisers Act Rel. No. 232 (Oct. 16, 1968).

[42] *See* Alfred C. Rizzo, Investment Advisers Act Rel. No. 897 (Jan. 11, 1984).

See also Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Rel. No. 1406 (Mar. 16, 1994).

[43] *See* Kingsley, Jennison McNulty & Morse Inc., Advisers Act Rel. No. 1396, 55 SEC Docket 2434, 2438 (Dec. 23, 1993).

SEC Commissioner Luis Aguilar recently summed up an investment adviser's fiduciary duty this way:

> As fiduciaries, investment advisers owe their clients 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 [their] clients". Accordingly, investment advisers are required to serve the best interests of their clients with undivided loyalty. An adviser that has a material conflict of interest must either refrain from acting upon that conflict, or it must fully disclose all material facts relating to that conflict, and obtain the informed consent of its clients, before acting. In addition, an investment adviser has the duty to seek best execution, to make suitable recommendations, and to have a reasonable basis for the investment advice that is provided to clients.[44]

At the baseline, the relationship between an investment adviser and client is grounded in a contract under which the adviser renders specific advisory or investment management services on a continuous basis throughout the term of the contract. Thus, it is easy to speak of an affirmative obligation that continues throughout a relationship. Yet, that is not normally the case between a securities broker and her customer, and, as discussed below, the difference in relationships has important consequences in defining the "fiduciary" duty of a broker.

It is true that in the discreet circumstances of receiving an investment recommendation, a broker-dealer retail customer normally has no reason to believe that her broker, in whom she has placed trust and confidence, operates under a different standard of conduct from that applicable to a hired investment adviser. As a practical matter, she may assume that *anyone* in whom she has placed trust and confidence in financial and investment matters owes a fiduciary duty. In broker-customer relationships today, this is borne out by the fact that "breach of fiduciary duty" claims abound in arbitration statements of claims against brokers. These claims are invariably premised on the assertion that the claimant customer placed special trust and confidence in his or her broker. During 2009 and continuing through October 2010, FINRA Dispute Resolution

[44] Aguilar, *supra* note 18.

reported breach of fiduciary duty as the most frequently appearing claim against broker-dealers in customer arbitrations.[45] Customers in these cases parrot common law fiduciary principles that a fiduciary relationship is one in which special confidence and trust is placed in the integrity and fidelity of another, and there is a resulting position of superiority or influence acquired by reason of this special trust that is breached by a variety of alleged misconduct.

As noted earlier, investor perceptions were addressed in the 2008 RAND Corporation report of its study of the investment adviser and broker-dealer industries, and the nature of their relationships with customers.[46] The SEC commissioned RAND to conduct a study of broker-dealers and investment advisers from two perspectives: First, to examine investment advisers' and broker-dealers' practices in marketing and providing financial products and services to individual investors; and second, to evaluate investors' understanding of the differences between investment advisers' and broker-dealers' financial products and services, duties, and obligations. RAND researchers concluded that there is confusion about investment adviser and broker-dealer titles and duties even among experienced investors.

Brokerage firm customers and investment adviser clients may have difficulty distinguishing among investment professionals, *if there is no reason to do so*. An investor entering into a written advisory contract with an investment adviser providing for specific services and fees based on portfolio values, and spelling out rights and obligations, can easily distinguish the relationship from that with a stockbroker who makes periodic recommendations based on profile information supplied by the customer. Presumably, the obvious difference in relationships explains the reason an advisory client has established that relationship in the first

---

[45] FINRA Dispute Resolution, *Summary Arbitration Statistics October 2010*, available at www.FINRA.org.

[46] RAND Corporation, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers" (2008) (the "RAND Report").

place. The question is whether from the perspective of the broker-dealer customer it matters. Are brokerage firm customers in fact being denied a higher level protection that should apply to their customer relationship? Arbitration claimants and their lawyers who regularly press breach of fiduciary duty claims against brokers apparently do not think so. The "fiduciary" duty of stockbrokers is examined below.

IV. THE FIDUCIARY DUTY OF STOCKBROKERS

Historically, broker-dealers, as agents who simply effected transactions directed by their clients, for which they were paid brokerage commissions, were not seen as being engaged in the business of advising. It was in this context that broker-dealers were excluded from the definition of "investment adviser" in the Investment Advisers Act when their performance of advisory services was "solely incidental" to their broker-dealer activities, and where they did not receive any "special compensation" for the advice.[47] This exclusion is the root of the contention that brokers are not subject to the same "fiduciary" responsibility as investment advisers, who are regulated under federal and state investment adviser laws.

Broker-dealers are regulated under the Securities Exchange Act of 1934 and SEC Rules under it, which impose significant requirements, and indeed, which also established a self-regulatory organization to add a level of principles-based regulation. Today, FINRA member firms and their associated persons are, first and foremost, bound in the conduct of their business to "observe high standards of commercial honor and just and equitable principles of trade."[48]

---

[47] Section 202(11) of the Investment Advisers Act of 1940, 15 U.S.C. §80b-2(11) (2000) provides in pertinent part:

> "Investment adviser" means 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…."

[48] FINRA Rule 2010, *FINRA Manual* (Wolters Kluwer) at 4111.

And, as a matter of state securities laws, under which actual licenses to engage in business as a broker-dealer or representative are granted, rules commonly address an array of dishonest or unethical business practices prohibited in the course of the business.[49]

The relationship between broker and customer has long been viewed by regulators and the courts as one involving trust and confidence placed by the customer with the broker. This principle is certainly manifested in the "suitability" obligation of brokers when making investment recommendations. However, fiduciary principles have, since the inception of the federal securities laws, been applied in policing the agency relationship in general, so as to prevent a broker from acting adversely to the best interests of the customer in dealings with that customer, and to require disclosures and other procedures designed to assure that customers make informed determinations with respect to their transactions. The relationship of trust and confidence between a broker and customer has been recognized particularly when the broker solicits reliance.[50] A broker's duty to customers is not, and never has been, defined solely in terms of "suitability." To the contrary, the basic duty has been described in decidedly fiduciary terms as follows:

> [A broker-dealer] is precluded from assuming an adverse role in his dealings with the customer in the absence of consent following full disclosure or any adverse interest and of such other information possessed by the broker-dealer as the customer should have to make an informed determination with respect to such dealings.[51]
>
> And, as the SEC observed in another early disciplinary case:
>
> Our findings… are based in large part on the premise that the relation of a securities dealer to his clients is not that of an ordinary merchant to his customers.

[49] *See, e.g.,* N.J. Admin. Code Sec. 13:47A-6.3.

[50] *See* Arleen W. Hughes, 27 S.E.C. 629, 634-35 (1948); Hughes v. SEC, 174 F.2d 969, 975 (D.C. Cir. 1949).

[51] E. Weiss, *Registration and Regulation of Brokers and Dealers* 104-105 (1965).

> Even apart from the relationship of agency which may exist, the status of a dealer in relation to an uninformed client is one of special trust and confidence, approaching and perhaps even equaling that of a fiduciary. [52]

In *Charles Hughes & Co. v. SEC,*[53] the U.S. Court of Appeals for the Second Circuit affirmed an SEC order revoking a broker-dealer's registration under section 15 of the Securities Exchange Act of 1934. The SEC charged that the broker-dealer took advantage of its customers' ignorance of true market conditions and capitalized on the confidence in itself which it had managed to instill in the customers. Affirming revocation, the *Hughes* court opined that in holding itself out to be competent to advise customers regarding investments, a broker-dealer implicitly represents that it will deal fairly, and not take advantage of a customer's ignorance.[54] Having instilled confidence, said the court, the failure to reveal overreaching and unfairness amounted to fraud within the ambit of the general antifraud provisions of the federal securities laws. This, of course, is the basis of the "Shingle Theory" of broker liability, which holds simply that a broker's solicitation and acceptance of orders from a customer constitutes an implied representation by the broker that she will deal fairly with the customer. The Shingle Theory is entirely premised upon the common fiduciary notion that there is a special relationship between the broker and its customer.

Courts have been quite willing to describe this in broad fiduciary terms --a duty of loyalty or due care-- depending upon particular facts and circumstances. In *Csordas v. Smith Barney, Harris, Upham & Co,.*[55] for example, a Florida state court characterized the law as being "clear that a securities broker owes to his investment customer a fiduciary duty of loyalty and due care"

[52] *See, e.g.,* William J. Stelmack Corp., 11 S.E.C. 601, 623 (1942).

[53] 139 F.2d 434 (2d Cir. 1943).

[54] *Id.,* at 437.

[55] [1992-1993 Transfer Binder] *CCH Fed.Sec.L.Rep.* ¶ 97,230 (Fla. Cir. Ct. July 16, 1992).

that requires in each transaction that the broker recommend a purchase "only after studying it sufficiently to become informed as to its nature, price and financial prognosis… and to inform the customer of the risks involved in purchasing a particular security."[56]

It has always been the case in *discretionary* account relationships that a broker owes the customer a fiduciary duty.[57] In these relationships the broker controls the account and is entrusted with authority to act as an investment manager on behalf of the customer. Discretionary and non-discretionary accounts have historically been differentiated in terms of the fiduciary relationship on the one hand, and an agency relationship on the other. In a non-discretionary account relationship the focus is transactional. However, it has always been the case that in a non-discretionary relationship, the broker nevertheless has a duty based on the agency relationship. One element of that duty is the duty to recommend suitable investments. But there has always been more. In *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[58] the court identified an array of duties owed by brokers in these circumstances as including:

- The duty to recommend a stock only after studying it sufficiently to become informed as to its nature and financial prognosis;
- The duty to carry out the customer's orders promptly in a manner best suited to serve the customer's interests;
- The duty to inform the customer of the risks involved in purchasing or selling a particular security;

[56] *See also* Gochnauer v. A.G. Edwards & Sons, Inc., 810 F.2d 1042, 1049 (11th Cir. 1987); Thropp v. Bache Halsey Stuart Shields, Inc., 650 F.2d 817 (6th Cir. 1981); Moholt v. Dean Witter Reynolds, Inc., 478 F. Supp. 451, 452 (D.D.C.) 1979 (brokers are quasi-fiduciaries "held to a high degree of trustworthiness and fair dealing");Ward v. Atlantic Security, 777 So.2d 1144 (Fla. 3d DCA 2001); State ex. rel. PaineWebber v. Voorhees, 891 S.W.2d 126 (Mo. 1995); Glisson v. Freeman, 532 S.E.2d 442 (Ga. App. 2000); Beckstrom v. Parnell, 730 So.2d 942 (La. App. 1st Cir. 1998).

[57] *See* SEC v. Zandford, 535 U.S. 813 (2002).

[58] 461 F. Supp. 951, 953 (E.D. Mich. 1978), *aff'd,* 647 F. 2d 165 (Table) (6th Cir. 1981).

- The duty to refrain from self-dealing or refusing to disclose any personal interest the broker may have in a particular recommended security;

- The duty not to misrepresent any fact material to the transaction; and

- The duty to transact business only after receiving prior authorization from the customer.[59]

In practice, the principal distinction between the duty of a broker in a discretionary account relationship as compared to a non-discretionary relationship has been a *continuing* duty, to monitor, to keep abreast of information affecting the portfolio, and to advise on an on-going basis. This is a continuous relationship during the period in which the relationship exists, rather than the *transactional* duty that operates in a non-discretionary relationship. The *Leib* court drew the distinction in this manner:

> Unlike the broker who handles a non-discretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense. Such a broker, while not needing prior authorization for each transaction, must (1) manage the account in a manner directly comporting with the needs and objectives of the customer as stated in the authorization papers or as apparent from the customer's investment and trading history, (2) keep informed regarding the changes in the market which affect his customer's interest and act responsively to protect those interests... (3) keep his customer informed as to each completed transaction... and (5) *[sic]* explain forthrightly the practical impact and potential risks of the course of dealing in which the broker is engaged.[60]

As discussed earlier, ahead of passage of Dodd-Frank, Rep. Spencer Bachus, in no uncertain terms, cautioned that the unique roles of different financial professionals, their distinct relationships with their customers, and the nature of services and disclosures they provide must be fully examined and well understood.[61] In the securities industry the distinct relationships between brokers and their customers have always defined the duty, be it fiduciary or something

[59] *Id* (citations omitted).

[60] 461 F. Supp. 953 (citations omitted).

[61] *See* note 20, *supra* and accompany text.

else, owed to those customers. Even in a non-discretionary account relationship, unique roles and distinct relationships have been found to compel a heightened "fiduciary" standard of conduct. In *Leib*, for example, the court had no problem characterizing the non-discretionary account relationship between the broker and his customer as one involving "special trust and confidence" placed by an uninformed customer, which gives rise to a special duty to the customer -- a duty of acting in the highest good faith toward the customer.[62] A strong SEC advocate of a "harmonized" fiduciary standard of conduct for broker-dealers made the same point pre-Dodd-Frank:

> [W]hat a fiduciary duty requires depends on the scope of the engagement. Thus, it will mean one thing for a mere order-taker, another thing for someone who provides a one-time financial plan, and yet something else for someone who exercises ongoing investment discretion over an account. What a fiduciary duty requires may also depend, in certain respects, on the sophistication of the investor. What may be appropriate behavior toward large institutional investors, with knowledgeable counsel, may not be appropriate behavior toward retail investors like Aunt Millie who are not always going to understand the meaning of disclosures regarding certain conflicts of interest.[63]

It is quickly apparent that fashioning a unified fiduciary duty for broker-dealers and investment advisers within the existing legal environment and regulatory structure is no simple task. Duties already governing the conduct of broker-dealers and their associated persons have evolved in response to the facts and circumstances of actual customer relationships. The fiduciary duty of an investment adviser is a static concept applied in a defined advisory client

---

[62] *Leib,* 461 F. Supp. At 954, citing Stevens v. Abbott, Proctor and Paine, 288 F. Supp. 836, 846 (E.D. Va. 1968).

See also Holmes v. Grubman, 286 Ga. 636, 691 S.E. 2d 196, 201-201 (Ga. 2010). The Georgia Supreme Court opined that a stockbroker and his customer have a fiduciary relationship, obligating the broker to exercise utmost good faith, and the court added:

> [T]he fiduciary duties owed by a broker to a customer with a non-discretionary account are not restricted to the actual execution of transactions. The broker will generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest.

[63] Speech by SEC Commissioner Elisse B. Walter to the Mutual Fund Directors Forum Ninth Annual Policy Conference, Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization? (May 5, 2009).

relationship which has from first recognition of the duty been seen as different from that between broker and customer. There is no one-size-fits-all duty applicable to the varying relationships between broker-dealers and their customers, let alone one that could be applied universally to them and to investment advisers. The challenge is made even greater by Dodd-Frank itself, which assures that for whatever unified standard of conduct might emerge: "[N]othing shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities."[64]

Yet, as described earlier by SEC Commissioner Luis Aguilar, the fiduciary duty of an investment adviser is an "affirmative obligation that continues throughout the relationship between an adviser and client and controls all aspects of their dealings."[65] Reconciliation of the statutory restriction on no continuing duty with at least this SEC Commissioner's view of the benchmark to which the SEC should aspire in rulemaking appears impossible, unless the fiduciary duty of an investment adviser is seen as something considerably less than broadly worded characterizations make it.

What elements of a unified "fiduciary" standard of conduct were actually envisioned in Dodd-Frank? Shortly before passage of the Act, Rep. Paul Kanjorski, Chair of the Capital Markets Subcommittee of the House Financial Services Committee, offered at least his view of the "traditional fiduciary duty" which would be central to new rules establishing that every financial intermediary who provides personalized investment advice to retail customers will have a fiduciary duty to the investor. The elements of a uniform fiduciary duty he envisioned under Dodd-Frank are:

---

[64] *Id.* (emphasis added).

[65] Aguilar, "A Shared Responsibility: Preserving the Fiduciary Standard," note 18, *supra.*

- An affirmative duty of care, loyalty and honesty;
- An affirmative duty to act in good faith; and
- A duty to act in the best interests of the client.[66]

If this is the "traditional fiduciary duty" that should now be ensconced in an SEC rule adopted in conformity with new section 211(g) of the Investment Advisers Act and amended section 15(b) of the Exchange Act, as setting the standard of conduct for all brokers, dealers, and investment advisers in providing personalized investment advice, then clearly there is a disconnect between the perception of what is desired and the reality of what is already in place. As a practical matter, combined with the "Shingle Theory" of responsibility, and FINRA's principles-based regulatory scheme, the broker duties identified earlier in *Leib* are duties of care, loyalty, honesty and fair dealing, applicable to brokers in non-discretionary relationships with their customers. These are entirely consistent with the elements of the unified standard of conduct envisioned by Rep. Kanjorski. Moreover, the extant fiduciary duty always applicable to broker-dealers in discretionary account relationships is simply not an issue. That being the case, the challenge presented now is identifying what "gap," if any, in the broker-dealer/investment adviser duty construct needs to be addressed by a new SEC rule setting out a unified standard of conduct? That question, and thoughts for keeping the on-going debate in proper perspective are discussed below.

V. FILLING A GAP?

The debate over a unified fiduciary duty applicable to broker-dealers and investment advisers has been framed as "suitability" versus "fiduciary duty." This is wrong for at least three reasons. First, there is an extant fiduciary duty which is already the standard of conduct for

---

[66] *Congressional Record*, June 30, 2010, at H5237

brokers in discretionary account relationships with customers. It may be no more defined than the benchmark fiduciary duty of investment advisers, but there has been no suggestion that it imposes any lesser responsibility to act in the best interests of a customer than would be enjoyed by an investment advisory client. Second, it is also recognized that, in particular facts and circumstances of a customer relationship, a broker may take on a fiduciary duty without regard to the non-discretionary label attached to an account. Third, any broker-dealer's duty to a client has never been defined solely in terms of suitability. Suitability is part of a broader responsibility to act in accord with duties and principles-based standards of conduct which have a markedly fiduciary character. It is unacceptably simplistic to define the duty debate as suitability versus fiduciary duty.

What then actually underlies a "gap" perception driving the initiative to a unified standard, ostensibly equating perceived duties of broker-dealers and investment advisers? One consideration dominates the debate. A fiduciary duty would require a broker-dealer making investment recommendations to "act in the best interests of their customers without regard to the financial or other interest of the [broker],"[67] with the focus of the debate almost entirely on broker compensation. It is said, given the current duty construct built only on a suitability responsibility, that a broker's objectivity and good faith in making a recommendation may be at least colored, if not compromised, based on compensation associated with a particular recommendation. The fact that higher compensation is available for an otherwise suitable recommendation versus that with an alternative (presumably in all ways equivalent, suitable and available) but less expensive product motivates behavior not in the best interest of the customer, namely, recommendation of the more expensive product. An investment adviser in the same

[67] Investment Advisers Act §211(g), 15 U.S.C. §80b-11(g) (2010).

circumstances, bound to place the client's interest ahead of any other consideration, would be compelled to advise the choice of an alternative.

The notion that Dodd-Frank compels rulemaking to assure that the broker would make the same choice is incorrect. In fact, Dodd-Frank recognizes that there may be good reason for recommendation of the more expensive alternative, without any regard to higher cost or compensation. As Congress made clear in new section 211(g) of the Investment Advisers Act: "The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer."[68] There is more.

Unquestionably, there is an inherent conflict of interest resulting from a broker's transaction-based compensation as an agent, while at the same time "advising" the investor as to an investment decision. That has always been the case, and the benchmark standard of conduct addressed by Dodd-Frank expressly contemplates that there will continue to be "material conflicts of interest" in these relationships. Dodd-Frank does not prohibit them. Rather, it authorizes rulemaking to require that they be disclosed, and that they be consented to by the customer.[69] The same is true for limitations on product offerings which may stand in the way of an alternative recommendation. In amended section 15(b) of the Exchange Act, Dodd-Frank provides:

> DISCLOSURE OF RANGE OF PRODUCTS OFFERED. --Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission by rule may require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer.

[68] *Id.*, Section 211(k).

[69] *Id.*

> The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself be considered a violation of the standard of conduct.... [70]

To put all of this in proper perspective, newly amended section 15(b) of the Exchange Act and new section 211(g) of the Investment Advisers Act, read *in pari materia*, establish the framework of what is to come in the wake of the SEC study now underway:

(1) The SEC *may* promulgate rules to unify the standard of conduct applicable to broker-dealers and investment advisers when providing personalized investment advice to retail customers, which standard 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 (and which in no event shall be a standard less stringent than that applicable to investment advisers under general antifraud provisions of the Investment Advisers Act); *and*

(2) In such rule(s) that may be adopted, the SEC *shall* require any material conflict of interest of the broker-dealer or investment adviser to be disclosed and that such conflict may be consented to by the customer; *and*

(3) The SEC *shall* facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest; *although*

(4) The receipt of transaction-based compensation or fees shall not alone be considered to be a violation of the standard of conduct requiring a broker-dealer or investment adviser to act in the best interest of the customer without regard to financial interest; *and*

---

[70] 15 U.S.C. §78o(k)(2) (2010).

(5) The SEC *may* also require notice to customers by a broker-dealer concerning the sale of proprietary or other limited range of products, as to which the SEC *may* require the customer to acknowledge or consent; *although*

(6) The sale of only proprietary or other limited range of products by a broker-dealer shall not alone be considered to be a violation of the applicable standard of conduct; *and, above all*

(7) Nothing required by the Dodd-Frank amendments shall require a broker-dealer or registered representative of a broker-dealer to have any continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.

From the broker-dealer perspective, what new "unified" broker-dealer/investment adviser standard of conduct could be formulated in a rule (or rules) based on the combined Dodd-Frank directives, beyond the simple admonition to do what is right for its customer in a particular transaction setting? Most broker-dealers, operating under settled duty principles discussed earlier, would find little new in that admonition. The common standard of conduct must be informed by what already is in place governing the conduct of broker-dealers and their associated persons in transactional settings. There are, and will remain, two separate regulatory structures and varying sets of broker-dealer customer and investment adviser client relationships. The caveat expressed earlier bears repeating. In considering any new rules setting a common standard for broker-dealers and investment advisers, who for decades have operated under separate regulatory structures that remain in place, it is critically important that the unique roles of each intermediary, their distinct relationships with the customers, and the nature of services and disclosures they provide, must be fully taken into account.

In a 2009 speech, without referencing any particular legislative initiative, SEC Commissioner Elise B. Walter addressed the goal of "harmonizing" the regulation of broker-dealers and investment advisers. She acknowledged the problem now manifested in the Dodd-Frank attempt to combine one element of two regulatory schemes, and advocated instead that:

> Congress should throw both statutes on the floor, and select what is best in each, and cover any holes through which the floor boards show. In doing so, Congress should look at every aspect of a financial professional's business, from the moment of its inception to its dissolution.[71]

Commissioner Walter offered that, with enabling legislation, Congress should, among other things, address combining the broker-dealer and investment adviser registration processes, combining licensing requirements for all associated persons, imposing disclosure obligations through a uniform disclosure document for all "financial professionals," requiring membership in a self-regulatory organization by all financial professionals, and providing that every financial professional be subject to a uniform fiduciary standard of conduct.[72] This represents fundamental structural change, any call for which was lost in the run-up to Dodd-Frank.

As it relates to the unified "fiduciary" duty for broker-dealers and investment advisers, Dodd-Frank accomplished nothing suggested by Commissioner Walter as the desirable goal of enabling legislation to address the whole of financial or investment professionals. Instead, Congress arguably made it impossible to fashion a rule which would set out the parameters of any new, unified, fiduciary standard. No clarity can come of the attempt to incorporate the seven elements of the Dodd-Frank duty construct presented above into any workable unified standard, particularly given the command of Dodd-Frank that nothing shall operate to create any continuing duty, which is the touchstone of investment adviser-client relationships, and which

---

[71] Walter, *supra* note 63.

[72] *Id.*

has never been defined in terms any more definite than what was quoted by SEC Commissioner Aguilar earlier.[73] It is surely not now defined by Dodd-Frank as anything more than to act in the best interest of a client. Broker-dealers, on the other hand, have operated under antifraud provisions of federal and state securities laws which have addressed particular conduct ("churning," for example), and markedly fiduciary-like agency law principles (as well as outright fiduciary duty in discretionary account relationships), and principles-based FINRA conduct rules. What might, nevertheless, emerge as a "new" rule?

VI. A LIMITING PERSPECTIVE

Clearly, there is a significant challenge in melding all that Dodd-Frank has prescribed into a unified "fiduciary" duty for broker-dealers and investment advisers. As a matter of perspective, however, it is also important to keep in mind that the specific focus of a rule enabled by Dodd-Frank is limited (unless the SEC decides otherwise) to "personalized investment advice" provided to "retail customers." Personalized investment advice is not defined in Dodd-Frank, but in context clearly connotes an active recommendation to an individual. For broker-dealers, presumably this would be a function of "solicited" versus "unsolicited" transactions. Is there perhaps a built-in limitation that would cabin a new duty sufficiently to avoid significant complications in attempting to fashion a workable rule within the parameters set by Dodd-Frank, and which would still equate a broker-dealer and investment adviser standard of care in a transaction-specific context?

Applied to broker-dealers, the duty to act in the best interest of the customer would, presumably, have the broker's suitability responsibility remain fully in place, but augmented by documented identification of such reasonable alternatives which are available, the comparative costs, expenses and benefits associated with each, and a justification for the particular

[73] *See supra*, note 18.

recommendation, including any product limitation involved and any proprietary interest in what is being recommended. But there is a wild card in moving ahead with this limited perspective.

The Dodd-Frank amendments to Exchange Act section 15(b) include another SEC rulemaking authorization, phrased in terms of a mandate. Exchange Act section 15(l)(2)[74] provides, among "other matters," that:

> The Commission shall--
>
> (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.[75]

The scope of rulemaking authority granted under this provision is such as to portend a profound impact on broker-dealer sales and compensation practices generally, depending upon the manner in which it is exercised. What it could mean for a unified fiduciary standard of conduct for broker-dealers and investment advisers is that conduct rules directed at one or the other in the name of implementing a unified fiduciary duty might in fact separate them even more than as perceived now. It is not difficult to predict where the brunt of any exercise of this authority would fall. Thus, while Dodd-Frank could, in the main, support a limited perspective addressing only expectations in giving advice or making investment recommendations, the power to go much further into uncharted waters in the name of a "fiduciary" duty makes it much more problematic, and uncertain.

VI. CONCLUSION

The challenge before the SEC as a result of a garbled Dodd-Frank legislative construct is large. Conceptually, a one-size-fits-all universal "fiduciary" standard of conduct for broker-

[74] 15 U.S.C. §78o(l)(2) (2010).

[75] *Id.*

dealers and investment advisers (albeit devoid of any attempt to give it meaning) could be fashioned if it is specifically focused on common functional characteristics of broker-customer and investment adviser-client relationships, and is framed in terms of a baseline obligation that gives some meaning to acting in the "best interest" of a customer or client. It remains to be seen, however, how simple or complex an emergent rule(s) will be, and whether in practical terms it is "new" at all. One thing is certain. As the SEC study moves ahead, for broker-dealers, all that has defined their role and responsibilities in the varying circumstances of customer account relationships supplies a necessary perspective on what is to come.