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Via electronic filing: rule-comments@sec.gov

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Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**RE: File No. S7-07-18 – Regulation Best Interest
File No. S7-08-18 – Form CRS Relationship Summary**

Chair Clayton, Commissioners and Staff of the U.S. Securities and Exchange Commission:

I submit these comments regarding in response to the recently released RAND Corporation report on investor testing of the Client Relationship Summary (CRS).¹ (“Form CRS”), and necessarily related thereto as additional comments regarding Regulation Best Interests (“Reg BI”).

I submit these comments as a researcher regarding the application of fiduciary law to the delivery of financial planning and investment advice.² *This letter is submitted on my own behalf, and not on behalf of any organization, firm, or institution to which I belong or may be affiliated.*

In summary, I observe:

- A. The disclosures in proposed Form CRS fail to enable investors to understand the differences between brokerage accounts (and arms-length relationships between product sellers and purchasers) and advisory accounts (and fiduciary-client relationships). The Commission must acknowledge the compelling academic research regarding the limited effectiveness of disclosures, and the limited effectiveness of a confusing proposed Form CRS.**
- B. Form CRS obfuscates distinctions between broker-dealers and investment advisers. The RAND report provides compelling evidence that the Commission’s proposed Form**

¹ Angela A. Hung, et al., Investor Testing of Form CRS Relationship Summary, Prepared for United States Securities and Exchange Commission, RAND Corporation, November 2018, <https://www.sec.gov/comments/s7-07-18/s70718-4628415-176399.pdf>.

² I am attorney-at-law for 32 years, an registered investment adviser representative for 17 years, a participant in financial advisory association committees and boards and as a speaker at conferences and symposia – and a researcher and commentator on fiduciary law as applied to financial services – for over 14 years, and a professor of finance and financial planning providing instruction in investments and financial planning for the past 6 years.² *This comment letter is submitted on my own behalf, and not on behalf of any institution, organization, association or firm with whom I may be associated.*

CRS disclosure fails to achieve its purpose – to clarify consumers’ understanding of the legal obligations their “financial advisor” owes to them.

- C. I propose a different disclosure, that empowers consumers to be informed regarding the true nature of the relationship with their investment adviser (and investment adviser representatives thereof) or broker-dealer (and registered representatives thereof).**
- D. The underlying problem is that the Commission, through its proposed Reg BI, seeks to re-define the term “best interests” in a manner that leads investors to believe that they can place trust and confidence in their broker-dealer and registered representatives, when such is not the case. Reg BI is a blatant attempt to re-define a term in the English language that is already well-defined. The term “best interests” has been an expression of the fiduciary duty of loyalty for centuries. Reg BI does not actually impose any obligation of a broker-dealer to act in a customer’s best interests.**
- E. The Commission’s economic analysis behind proposed Form CRS and Reg BI is fundamentally flawed. Capital formation will be deterred and U.S. economic growth will be harmed if these proposed regulations are adopted.**
- F. The Commission, should it proceed with Form CRS and Reg BI, will be aiding and abetting a massive fraud upon consumers, and Chair Clayton and any Commissioners supporting these regulations will cause the U.S. Securities and Exchange Commission to become the laughing stock of the regulatory world and the least effective of all national and state regulators.**

My more detailed comments and suggestions follow.

- A. The disclosures in proposed Form CRS fail to enable investors to understand the differences between brokerage accounts (and arms-length relationships between product sellers and purchasers) and advisory accounts (and fiduciary-client relationships). The Commission must acknowledge the compelling academic research regarding the limited effectiveness of disclosures, and the limited effectiveness of a confusing proposed Form CRS.**

Participants in the RAND study often thought that fiduciary implies acting in the customer’s best interest. This is consistent with both the requirements of fiduciary law as well as the common understanding among consumers that a fiduciary is a firm or person who acts under a duty of loyalty to the entrustor and, as a result, should seek to avoid conflicts of interest (which is consistent with the common law application of the “no conflicts” rule applicable to fiduciary-entrustor relationships). Not surprisingly, many participants in the RAND study expressed confusion over the “Conflicts of Interest” section, including struggling to reconcile the information in that section with the previous “Our Obligations to You” section.

As observed in comment letter on Form CRS from many leading consumer and financial planning organizations, “A significant percentages of investors stated in response to survey questions that important sections of the proposed Form CRS were ‘difficult’ or ‘very difficult’ to understand. For example, almost one-quarter of respondents described the ‘Types of Relationships and Services’ and ‘Our Obligations to You’ sections as ‘difficult’ or ‘very difficult’ to understand. The responses were even higher for the ‘Fees and Costs’ and ‘Conflicts of Interest’ sections, with approximately 35 percent of respondents describing these sections as

‘difficult’ or ‘very difficult’ to understand. It is deeply troubling that huge swaths of retail investors, based on their own assessments, are likely to experience difficulty in understanding these critical components of the disclosure.”

The Commission must acknowledge that, *even* if the fatal flaws of Reg BI and Form CRS can be fixed, that disclosures are largely ineffective as a means of investor protection. It is for this reason that a bona fide fiduciary standard is applied upon those who seek to provide trusted advice. Even in the 1930’s, the perception existed that disclosures would prove to be inadequate as a means of investor protection, as observed long ago by Professor Schwarcz:

Analysis of the tension between investor understanding and complexity remains scant. During the debate over the original enactment of the federal securities laws, Congress did not focus on the ability of investors to understand disclosure of complex transactions. Although scholars assumed that ordinary investors would not have that ability, they anticipated that sophisticated market intermediaries – such as brokers, bankers, investment advisers, publishers of investment advisory literature, and even lawyers - would help filter the information down to investors.³

It must also be observed that the statement - “Sunlight is the best disinfectant” – is just not true. In a paper by Professors Daylian Cain, George Loewenstein, and Don Moore, “The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest,” they challenged the belief of some that disclosure can be a reliable and effective remedy for the problems caused by conflicts of interest, and concluded:

In sum, we have shown that disclosure cannot be assumed to protect advice recipients from the dangers posed by conflicts of interest. Disclosure can fail because it (1) gives advisors strategic reason and moral license to further exaggerate their advice, and (2) the disclosure may not lead to sufficient discounting to counteract this effect. The evidence presented here casts doubt on the effectiveness of disclosure as a solution to the problems created by conflicts of interest. When possible, the more lasting solution to these problems is to eliminate the conflicts of interest. As Surowiecki (2000) commented in an article in the New Yorker dealing specifically with conflicts of interest in finance, ‘transparency is well and good, but accuracy and objectivity are even better. Wall Street doesn’t have to keep confessing its sins. It just has to stop committing them.’⁴

In another paper co-authored by Professor Cain, he again noted that disclosures of conflict of can often lead to worse advice being delivered to the consumer, observing that biased and corrupt advice will follow after disclosures of conflicts of interest occur:

Conflicts of interest can lead experts to give biased and corrupt advice. Although disclosure is often proposed as a potential solution to these problems, we show that it can have perverse effects. First, people generally do not discount advice from biased advisors as much as they should, even when advisors’ conflicts of interest are honestly disclosed. Second, disclosure can increase the bias in advice because it leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further. This means that while disclosure may [insufficiently] warn an audience to discount an expert-opinion, disclosure might also lead the expert to alter the opinion offered and alter it in such a way as to overcompensate for any discounting that might occur. As a result, disclosure may fail to solve the problems created by conflicts of interest and it may sometimes even make matters worse.⁵

³ Steven L. Schwarcz, Rethinking The Disclosure Paradigm In A World Of Complexity, Univ.Ill.L.R. Vol. 2004, p.1, 7 (2004), citing “Disclosure To Investors: A Reappraisal Of Federal Administrative Policies Under The ‘33 and ‘34 Acts (The Wheat Report),” 52 (1969); accord William O. Douglas, “Protecting the Investor,” 23 YALE REV. 521, 524 (1934).

⁴ Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=480121.

⁵ Cain, Daylian M., Loewenstein, George F. and Moore, Don A., The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest (December 1, 2003). Available at SSRN: <http://ssrn.com/abstract=480121>

Furthermore, the dimensions of the biases of advisors, when attempting to deal with non-avoided conflicts of interest, was revealed in a paper (citing earlier research by Professor Cain and others) Professor Antonia Argandoña wrote:

As a rule, we tend to assume that competent, independent, well trained and prudent professionals will be capable of making the right decision, even in conflict of interest situations, and therefore that the real problem is how to prevent conscious and voluntary decisions to allow one's own interests (or those of third parties) to prevail over the legitimate interests of the principal – usually by counterbalancing the incentives to act wrongly, as we assume that the agents are rational and make their decisions by comparing the costs and benefits of the various alternatives.

Beyond that problem, however, there are clear, unconscious and unintended biases in the way agents gather, process and analyze information and reach decisions that make it particularly difficult for them to remain objective in these cases, because the biases are particularly difficult to avoid. It has been found that,

- The agents tend to see themselves as competent, moral individuals who deserve recognition.
- They see themselves as being more honest, trustworthy, just and objective than others.
- Unconsciously, they shut out any information that could undermine the image they have of themselves – and they are unaware of doing so.
- Also unconsciously, they are influenced by the roles they assume, so that their preference for a particular outcome ratifies their sense of justice in the way they interpret situations.
- Often, their notion of justice is biased in their own favor. For example, in experiments in which two opposed parties' concept of fairness is questioned, both tend to consider precisely what favors them personally, even if disproportionately, to be the most fair.
- The agents are selective when it comes to assessing evidence; they are more likely to accept evidence that supports their desired conclusion, and tend to value it uncritically. If evidence contradicts their desired conclusion, they tend to ignore it or examine it much more critically.
- When they know that they are going to be judged by their decisions, they tend to try to adapt their behavior to what they think the audience expects or wants from them.
- The agents tend to attribute to others the biases that they refuse to see in themselves; for example, a researcher will tend to question the motives and integrity of another researcher who reaches conclusions that differ from her own.
- Generally speaking, the agents tend to give far more importance to other people's predispositions and circumstances than to their own.

For all these reasons, agents, groups and organizations believe that they are capable of identifying and resisting the temptations arising from their own interests (or from their wish to promote the interests of others), when the evidence indicates that those capabilities are limited and tend to be unconsciously biased.⁶

The SEC's emphasis on disclosure, drawn from the focus of the 1933 and 1934 Securities Acts on enhanced disclosures, results from the myth that investors carefully peruse the details of disclosure documents that regulation delivers. However, under the scrutinizing lens of stark reality, this picture gives way to an image a vast majority of investors who are unable, due to behavioral biases and lack of knowledge of our complicated financial markets, to undertake sound investment decision-making. As stated by former SEC Commissioner Troy A. Paredes, in a paper written while he was a professor:

The federal securities laws generally assume that investors and other capital market participants are perfectly rational, from which it follows that more disclosure is always better than less. However,

⁶ Anonia Argandoña, *Conflicts of Interest: The Ethical Viewpoint* (2004).

investors are not perfectly rational. Herbert Simon was among the first to point out that people are boundedly rational, and numerous studies have since supported Simon's claim. Simon recognized that people have limited cognitive abilities to process information. As a result, people tend to economize on cognitive effort when making decisions by adopting heuristics that simplify complicated tasks. In Simon's terms, when faced with complicated tasks, people tend to 'satisfice' rather than 'optimize,' and might fail to search and process certain information.⁷

A growing body of academic research into the behavioral biases of investors reveals substantial obstacles individual investors must overcome in order to make informed decisions. As stated by Professor Ripken:

[E]ven if we could purge disclosure documents of legaleze and make them easier to read, we are still faced with the problem of cognitive and behavioral biases and constraints that prevent the accurate processing of information and risk. As discussed previously, information overload, excessive confidence in one's own judgment, overoptimism, and confirmation biases can undermine the effectiveness of disclosure in communicating relevant information to investors. Disclosure may not protect investors if these cognitive biases inhibit them from rationally incorporating the disclosed information into their investment decisions. No matter how much we do to make disclosure more meaningful and accessible to investors, it will still be difficult for people to overcome their bounded rationality. The disclosure of more information alone cannot cure investors of the psychological constraints that may lead them to ignore or misuse the information. If investors are overloaded, more information may simply make matters worse by causing investors to be distracted and miss the most important aspects of the disclosure ... The bottom line is that there is 'doubt that disclosure is the optimal regulatory strategy if most investors suffer from cognitive biases' ... While disclosure has its place in a well-functioning securities market, the direct, substantive regulation of conduct may be a more effective method of deterring fraudulent and unethical practices.⁸

Furthermore, academic research reveals the inability of individual investors to contract for their own protection. Professor Prentice summarizes:

Respected commentators have floated several proposals for startling reforms of America's seventy-year-old securities regulation scheme. Many involve substantial deregulation with a view toward allowing issuers and investors to contract privately for desired levels of disclosure and fraud protection. The behavioral literature explored in this Article cautions that in a deregulated securities world it is exceedingly optimistic to expect issuers voluntarily to disclose optimal levels of information, securities intermediaries such as stock exchanges and stockbrokers to appropriately consider the interests of investors, or investors to be able to bargain efficiently for fraud protection.⁹

Additionally, it must be noted that financial advisors use consumers' behavioral biases to their own advantage. As stated by Professor Prentice, "instead of leading investors away from their behavioral biases, financial professionals may prey upon investors' behavioral quirks ... Having placed their trust in their brokers, investors may give them substantial leeway, opening the door to opportunistic behavior by brokers, who may steer investors toward poor or inappropriate investments."¹⁰

Indeed, I have myself personally observed many providers of investment and financial advice undertake training by marketing consultants, which in turn leads such advice providers to then take advantage of the behavioral biases of consumers. The instruction typically involves training in a series of actions to build a relationship of trust and confidence with the client first, far before any discussion of the service to be

⁷ Troy A. Parades, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 83 Wash.Univ.L.Q. 907, 931-2 (2003).

⁸ Ripken, Susanna Kim, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*. Baylor Law Review, Vol. 58, No. 1, 2006; Chapman University Law Research Paper No. 2007-08.

⁹ See Robert Prentice, *Whither Securities Regulation Some Behavioral Observations Regarding Proposals for its Future*, 51 Duke Law J. 1397 (March 2002).

¹⁰ Stephen J. Choi and A.C. Pritchard, "Behavioral Economics and the SEC" (2003), at p.18.

provided or the fees for such services. It is well known among these marketing consultants that, once a relationship of trust and confidence is established, clients and customers will agree to most anything in reliance upon the perceived binding nature of the trust relationship which has been formed.

Why are disclosures so ineffective as a means of consumer protection? In a paper exploring the limitations of disclosure on clients of stockbrokers, Professor Robert Prentice explained several behavioral biases which combine to render disclosures ineffective: (1) Bounded Rationality and Rational Ignorance; (2) Overoptimism and Overconfidence; (3) The False Consensus Effect; (4) Insensitivity to the Source of Information; (5) Oral Versus Written Communications; (6) Anchoring; and (7) Other Heuristics and Biases. Moreover, as Professor Prentice observed: “Securities professionals are well aware of this tendency of investors, even sophisticated investors, and take advantage of it.”¹¹

Much other academic research into the behavioral biases faced by individual investors has been undertaken, in demonstrating the substantial challenges faced by individual investors in dealing with those providing financial advice in a conflict of interest situation. The Commission’s analysis of any proposal relating to the application of a “best interests” standard, or which suggests a disclosure-based regime, must take into account the growing body of recent academic research that reveals the substantial ineffectiveness of disclosures as a means of consumer protection. Failure to consider the implications of modern academic research regarding the ineffectiveness – and often harm – caused by a disclosure-based regulatory emphasis, will lead to a substantially incomplete economic analysis underlying the proposed rules, thereby failing to satisfy the requirements of the Administrative Procedures Act.

B. Form CRS obfuscates distinctions between broker-dealers and investment advisers. The RAND report provides compelling evidence that the Commission’s proposed Form CRS disclosure fails to achieve its purpose – to clarify consumers’ understanding of the legal obligations their “financial advisor” owes to them.

As observed in a comment letter submitted by many leading consumer and financial services organizations on the RAND Corporation’s report, “Some participants felt that both the ‘Brokerage Account and ‘Advisory Account’ columns in the Relationship Summary were essentially conveying the same message, just using different words, while other participants interpreted the section as conveying that advisory accounts have a different standard from brokerage accounts.”

I also observe that, in many of the comment letters submitted by broker-dealer firms and their lobbying organizations, they describe the role of the broker-dealer today as a deliverer of “financial advice” or “investment advice.” And broker-dealers most frequently describe their registered representatives as “financial advisors” and “financial consultants.” There exists a simple precept, as old as writ, that acts to deter actual fraud in the delivery of goods and services ... “Say What You Do, Do What You Say.” Furthermore, state common law decisions have long held that representing oneself as a “financial advisor” or “financial planner” (or similar terms) is a key factor in determining whether a relationship of trust and confidence is formed to which broad fiduciary duties attach.

If broker-dealer firms desire to provide *investment advice* and/or *financial advice*, then they should accept the obligations that flow – under state common law (which can and should inform the Commission in its

¹¹ Robert Prentice, WHITHER SECURITIES REGULATION? SOME BEHAVIORAL OBSERVATIONS REGARDING PROPOSALS FOR ITS FUTURE, 51 Duke L.J. 1397 (available at <http://www.law.duke.edu/shell/cite.pl?51+Duke+L.+J.+1397#H2N5>). [Note, when I read this paper, several years ago, it sealed for me the importance of the bona fide fiduciary standard to consumers.]

application of federal securities law – notably, the application of the fiduciary standard of conduct and its fiduciary duties of due care, loyalty, and utmost good faith.

The Commission sets the floor for standards of conduct, not the ceiling. The Commission must acknowledge that it is highly likely that Reg BI and Form CRS, whether separately viewed or in combination, if adopted, will accelerate the findings by judges and arbitrators that brokers are acting as fiduciaries under state common law (the source of most remedies for clients for breach of a fiduciary obligation). Both Reg BI and Form CRS represent to consumers that brokers act in the “best interest” of the consumer – and this induces reliance and leads to a relationship of trust and confidence.

Many state courts, applying state common law to broker-customer relationships in which consumers have reasonably placed trust and confidence in the broker, have held that the relationship is or may constitute a fiduciary relationship between the broker and the customer. *See, e.g., Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007) (“Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms’-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entruster. The relationship goes well beyond a traditional arms’-length business transaction that provides ‘mutual benefit’ for both parties.”). *See also U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006); *Sergeants Benevolent Assn. Annuity Fund v. Renck*, 4430 (NY 6/2/2005) (NY, 2005); *Halleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005); *Fraternity Fund v. Beacon Hill Asset*, 376 F.Supp.2d 385, 414 (S.D.N.Y., 2005) (the customer “relied upon superior knowledge. Asset Alliance allegedly was plaintiff’s investment advisor and committed to ‘monitor the status and performance of [Beacon Hill and Bristol] at least once a month and [to] promptly inform Sanpaolo if, for any reason, it believes that [Beacon Hill or Bristol] should be de-selected.’ These allegations are sufficient to plead a fiduciary relationship.”); *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002) (“[T]he evidence established that Rosser was a licensed stockbroker and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship.”); *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990); *MidAmerica Federal Savings and Loan Ass’n v. Shearson / American Express Inc.*, 886 F.2d 1249 (10th Cir. 1989) (The court found a fiduciary relationship under Oklahoma law between a broker and his client in circumstances where the broker held himself out as having superior knowledge and expertise and the client reasonably placed his confidence in the broker.); and *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985).

The Commission and its staff should review the foundational concepts of fiduciary law. This is not rocket science. This is the simple application of centuries-old legal principles that serve to deter both actual fraud and misrepresentation, and which further serve to combat constructive fraud (including a breach of a fiduciary obligation). The Commission should review the common law of fiduciary duties - and be properly informed by such state common law, and the Commission should review the common law of fraud and misrepresentation – and be informed by it – prior to undertaking any action. The Commission should not move forward without a correct understanding of the need to combat both actual fraud and constructive fraud – for currently Form CRS and Reg BI aid and abet fraud, rather than deter it.

C. I propose a different disclosure, that empowers consumers to be informed regarding the true nature of the relationship with their investment adviser (and investment adviser representatives thereof) or broker-dealer (and registered representatives thereof)

As I note above, disclosures are largely ineffective as a means of investor protection. Proper regulation in this area would apply a bona fide fiduciary standard of conduct, recognizing the inability of consumers to protect themselves in today's modern financial world.

I would observe that proposed Form CRS is so fundamentally flawed that there is no reasonable basis for the Commission to move forward with same. This flaw flows from, as I explain in subsequent sections, the Commission's inherently inappropriate and nonsensical attempt to redefine the term "best interests" as something other than the application of the fiduciary duty of loyalty.

However, some commentators on Form CRS (broker-dealer firms, whose interests would be served by the obfuscation of the distinctions between brokers and investment advisers, and who know that disclosures are ineffective) – have recently observed that no disclosure form is "perfect" and that the Commission should move forward with an imperfect disclosure. I desire to refute this proposition.

Should the Commission desire to adopt a disclosure document, there is a far better form that could be utilized, that would provide consumers with much more useful information and which would more clearly provide consumers with information that permits them to understand the role their broker or investment adviser is in, and the duties owed (or not owed) to the consumer. I propose such an alternative in the four pages that follow, as part of the following alternative rule proposal. This form would be *far more effective* than the Commission's proposed Form CRS, and should be considered as the Commission undertakes any rulemaking in this area:

UNIFORM DISCLOSURE FORM FOR BROKER-DEALERS, REGISTERED REPRESENTATIVES, INVESTMENT ADVISERS, AND INVESTMENT ADVISER REPRESENTATIVES

- a) Whenever investment advice is provided to a client, then a uniform disclosure form ("UDF") shall be completed and provided by the broker-dealer, agent or adviser to the client at the inception of the client relationship, and annually during each calendar year thereafter during the duration of the client relationship, which UDF shall be substantially in the form set forth below.
- b) The UDF shall be and remain as a separate document and shall remain apart from and distinct from any other contracts, agreements, or other disclosures made to the client. If delivered electronically to the client, notification of electronic delivery of the UDF shall refer to: "Important Annual Relationship Disclosure" in the subject heading of the communication and no other substantial information shall be provided to the client in such communication other than the UDF.
- c) Should any material modifications occur to the disclosures contained in the UDF previously provided to the client, more than 15 days prior to the annual re-delivery of the UDF, the broker-dealer and/or adviser shall modify the disclosures previously provided through a written amendment thereto. Such amendment need not be in the format of the UDF, provided that the material modifications are relatively minor.
- d) The agent and/or adviser shall ensure that the client has received and reasonably understands the disclosures provided in the UDF and any amendments thereto. The agent and/or adviser shall fully and completely answer any questions posed by clients which relate to the subject matter of the UDF.
- e) Completion and delivery of the UDF does not fulfill the entirety of the fiduciary or other duties owed to the client by the provider of investment advice.

- f) The UDF provided shall be in substantially the following format and with substantially the following content:

[SEE NEXT FOUR PAGES FOR FORM]

**UNIFORM DISCLOSURE FORM TO INVESTMENT CONSUMERS
WHO ARE IN RECEIPT OF INVESTMENT ADVICE
FROM INVESTMENT ADVISERS OR BROKERS**

Name of Broker-Dealer (Company)
Providing Investment Advice:

Name of Investment Adviser (Firm)
Providing Investment Advice:

Note to dual registrants: complete both the "broker-dealer" and "investment adviser" listings above.

1. IS YOUR INVESTMENT PORTFOLIO INVESTED "PRUDENTLY"? Is the Prudent Investor Rule applicable to all or the majority of your investment portfolio?

 YES
(if checked)

All or the majority of your investment portfolio upon which we, your broker-dealer firm (and registered representatives thereof) and/or investment advisers (and representatives thereof), provide investment advice is advised upon and/or managed according to the dictates of the prudent investor rule, which requires that such portion of your investment portfolio be managed as a prudent professional would manage the portfolio, after considering your needs, goals, investment time horizon(s). In satisfying this standard, we are required to exercise due care, skill, and caution. In adherence to the prudent investor rule, we possess a duty to minimize idiosyncratic (diversifiable) risk, we are required to not waste your assets, and we possess other duties.

Assets, if any Excluded:

While the majority of your portfolio is subject to the prudent investor rule, the following account(s) or investment assets are excluded from the application of the prudent investor rule:

 NO
(if checked)

All or the majority of your investment portfolio upon which we, your broker-dealer firm (and agents thereof) and/or investment advisers (and representatives thereof), provide investment advice is NOT advised upon and/or managed according to the dictates of the prudent investor rule. As such, you understand that additional risks, fees and costs may exist within your investment portfolio which exceed those in a prudent portfolio.

Exceptions:

While the majority of your portfolio is NOT subject to the prudent investor rule, the prudent investor rule is applied by us to following account(s) or investment assets:

2. WHAT FORM OF INVESTMENT ADVICE IS PROVIDED TO YOU? Is the registered representative of your broker or the representative of your investment adviser an “independent adviser” or “restricted adviser” – or is “no advice” provided to you?

<p>_____</p> <p>Independent Adviser (if checked)</p>	<p>We, your broker-dealer firm (and registered representatives thereof) and/or investment advisers (and representatives thereof), possess the ability to provide a sufficient range of relevant investment strategies and financial products available on the market which are sufficiently diverse with regard to their type and with regard to the number of issuers or product providers to ensure that your investment objectives can be appropriately met. As to any investment advice we provide to you, we are required to implement a due diligence process in which we compare a broad range of investment strategies and financial instruments.</p>
<p>_____</p> <p>Restricted Adviser (if checked)</p>	<p>We, your broker-dealer firm (and registered representatives thereof) and/or investment advisers (and representatives thereof), can only provide “restricted advice” (also called “non-independent advice”), for the following reasons (<i>set forth the restrictions here</i>):</p>
<p>_____</p> <p>No Advice Provided (if checked)</p>	<p>We, your broker-dealer firm (and registered representatives thereof), do not provide investment advice to you. We may describe the features and characteristics of a financial product or investment to you. We may not, however, advise you as to whether the financial product or investment is in your best interests or whether the financial product is the best product in the marketplace to seek you meet your needs and goals.</p>

3. WHAT FORM OF RELATIONSHIP ARE YOU IN? Are you in a fiduciary-client relationship in which you are entitled to rely upon the investment advice you receive, or are you in an arms-length (seller-purchaser) relationship in which you must protect yourself?

<p>_____</p> <p>A Fiduciary-Client Relationship Exists</p>	<p>We, your broker-dealer firm (and registered representatives thereof) and/or investment advisers (and representatives thereof), possess broad fiduciary duties to you in all aspects of our business relationship with you, including but not limited to:</p> <ol style="list-style-type: none"> 1. The duty to act with due care with regard to any financial or investment advice we provide to you, which means that we must act with the skill, prudence and diligence of an expert in providing financial or investment advice to you. 2. The duty to act in your best interests, under the duty of loyalty, which includes the requirement to keep your interest paramount to our own interests, and that we act without regard to the financial or other interests of ourselves or our affiliated entities. 3. The duty to be completely honest with you, with a high degree of candor. 4. The duty to receive only reasonable compensation. 5. The duty to not undertake any material misrepresentations of fact to you.
<p>_____</p> <p>A Seller-Purchaser, Arms-Length Relationship Exists</p>	<p>We, your broker-dealer firm (and agents thereof), are not acting as your fiduciary. In connection therewith:</p> <ol style="list-style-type: none"> 1. Our relationship with you is that of the seller of a financial product to you, the purchaser of that product. We are in an arms-length relationship with you. 2. We may favor our own interests over yours. We are <i>not legally required</i> to act in your best interests. 3. We do not possess a broad duty of due care with regard to our financial product recommendations to you. Any product we recommend to you need only be “suitable.”

Your Broker or Adviser should check all those applicable, in the boxes below:

4. WHAT TYPES OF FEES AND OTHER COMPENSATION ARE RECEIVED BY YOUR BROKER-DEALER OR INVESTMENT ADVISER? What forms of compensation might your broker-dealer (or any affiliate thereof) or investment advisor (or any affiliate thereof) receive as a result of their relationship with you?

FEES PAID DIRECTLY BY YOU	
	Investment advisory fees paid directly by you based upon a percentage of the assets upon which advice is provided
	Investment advisory fees paid directly by you of a fixed or flat fee nature, paid either annually, quarterly, or monthly
	Investment advisory fees paid directly by you based upon hourly fees
	Investment advisory fees paid directly by you for discrete projects
FEES PAID BY PRODUCT MANUFACTURERS OR OTHER INTERMEDIARIES	
	Sales commissions (including but not limited to front-end sales loads for mutual fund shares, and including but not limited to front-end commissions for annuities) resulting from sales or purchases of securities, other investments, or annuity/insurance products to you
	Sales commissions in the form of deferred contingent sales charges or back-end loads resulting from selling or purchasing securities, other investments, or annuity/insurance products to or from you
	Mark-ups and mark-downs in connection with principal trading of securities (i.e., where the broker-dealer firm purchases securities directly from you, or sells securities directly to you, from the broker-dealer's own accounts)
	For any securities sold to you, compensation derived from the issuer or stocks, bonds, or other securities relating to the investment underwriting activities of the broker-dealer
	12b-1 fees paid by mutual funds to your brokerage firm, which fees last indefinitely as long as you own the fund, regardless of whether you continue to receive investment advice from us
	12b-1 fees paid by mutual funds to your brokerage firm, which fees will last for only a fixed period of time before they disappear, but which fees may continue during that period of time, regardless of whether you continue to receive investment advice
	Other than 12b-1 fees, any other form of fees or trailing commissions paid to your brokerage firm resulting from the sale of securities, other investments, or annuity/insurance products to you, which fees or trailing commissions last indefinitely as long as you own the security, other investment, or annuity/insurance product, regardless of whether you continue to receive investment advice from us
	Other than 12b-1 fees, any other form of trailing commissions paid to your brokerage firm resulting from the sale of securities, other investments, or annuity/insurance products to you, which fees or trailing commissions last for only a fixed period of time before they disappear, but which fees may continue during that period of time, regardless of whether you continue to receive investment advice from us
	Payment for shelf space received by your broker-dealer. (A shelf-space agreement occurs when a mutual fund pays this additional compensation in exchange for the broker-dealer preferentially marketing the shares of that mutual fund.)

(-cont.) FEES AID BY PRODUCT MANUFACTURERS OR OTHER INTERMEDIARIES

	Marketing support payments paid by product manufacturers or intermediaries to your broker-dealer or investment adviser arising from the sales of securities or annuity/insurance products to you
	Other revenue sharing payments paid by product manufacturers to your broker-dealer or investment adviser
	Fees and/or commissions resulting from sales of securities for which your broker-dealer acts as underwriter or as part of an underwriting group
	Any other fees and/or commissions received for referrals by your broker-dealer firm of you to any other product or service provider that are not set forth above
	Receipt by your broker-dealer of payments for order flow from other brokerage firms (including but not limited to market makers) (these compensation payments benefit a brokerage firm for directing orders to different parties for trade execution)
	Receipt by your brokerage firm of soft dollar compensation received from managed accounts (including but not limited to mutual funds). Note that Section 28(e) of the (federal) Securities Exchange Act of 1934 discretion with respect to an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty under state or federal law solely by reason of his having caused an account to pay more than the lowest available commission if that person determines in good faith that the amount of the commission is reasonable in relation to the value of the brokerage and research services provided.
	Other than as previously described, any receipt by your broker or investment adviser of access to software, research, trading software, practice management and/or investment education (though attendance at conference, via webinars, written materials, or otherwise), or other support services from any other brokerage firm, custodian, or product manufacturer.
	Any other forms of revenue sharing or other payments, paid by product manufacturers or intermediaries, to your broker-dealer or investment adviser arising from the sales of securities, other investments, or annuity/insurance products to you, other than as previously described: <i>(Broker-dealer and/or investment adviser: adequately describe such forms of revenue sharing or other payment arrangements, in the space set forth below):</i>

D. The underlying problem is that the Commission, through its proposed Reg BI, seeks to re-define the term “best interests” in a manner that leads investors to believe that they can place trust and confidence in their broker-dealer and registered representatives, when such is not the case. Reg BI is a blatant attempt to re-define an already defined term in the English language. The term “best interests” has been an expression of the fiduciary duty of loyalty for centuries. Reg BI does not actually impose any obligation of a broker-dealer to act in a customer’s best interests.

The Investment Advisers Act of 1940’s fiduciary standard of conduct is a “best interests” fiduciary standard of conduct. The Commission has always applied to investment advisers the “best interests” standard¹² found in the Investment Advisers Act of 1940, which is a codification of state common law. Yet, Reg BI seeks to redefine the term “best interests” to mean something altogether different from the fiduciary standard – and in particular the fiduciary duty of loyalty and the heavy requirements imposed upon a fiduciary when a conflict of interest is not avoided.

By way of further explanation, under the Advisers Act’s fiduciary standard, an investment adviser is required to all times place and maintain his or her or its client's best interests¹³ first and paramount to those of the advisor.¹⁴ The advisor is under an affirmative obligation to reasonably avoid all conflicts of interest¹⁵ which would impair the independent and objective advice rendered to the client. As to any remaining conflict of interest which is not reasonably avoided, the advisor must undertake full and affirmative disclosure of such

¹² As to the “best interests” standard being present under the Advisers Act, see *S.E.C. v. Moran*, 922 F.Supp. 867, 895-6 (S.D.N.Y., 1996) (“the SEC alleges that by allocating Liberty stock to his personal and family accounts and requiring his clients to pay a higher price for the stock the next day, Moran Sr. and Moran Asset placed their own interests ahead of their clients thereby violating the fiduciary duty owed to those clients ... Section 206 of the Advisers Act establishes a statutory fiduciary duty for investment advisers to act for the benefit of their clients, requiring advisers to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17, 100 S.Ct. 242, 246, 62 L.Ed.2d 146 (1979); *Burks v. Lasker*, 441 U.S. 471, 482 n. 10, 99 S.Ct. 1831, 1839 n. 10, 60 L.Ed.2d 404 (1979); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 n. 11, 97 S.Ct. 1292, 1300 n. 11, 51 L.Ed.2d 480 (1977); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92, 84 S.Ct. 275, 282-83, 11 L.Ed.2d 237 (1963) ... [T]he court interprets Section 206 to establish a fiduciary duty which in addition to applying to misrepresentations and omission, also requires the investment advisor to act in the best interests of its clients. See e.g., *SEC v. Capital Gains Bureau*, 375 U.S. at 195, 84 S.Ct. at 284-85 (‘Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation ‘enacted for the purpose of avoiding frauds,’ not technically and restrictively, but flexibly to effectuate its remedial purposes.’)”

¹³ In contrast to the “best interests” standard traditionally imposed upon investment advisers and financial planners under the Investment Advisers Act of 1940 and state common law, ERISA (at least prior to amendments made by the Pension Protection Act of 2006) imposed a “sole interests” standard. See *Keach v. U.S. Trust Co. N.A.*, 313 F.Supp.2d 818 (C.D. Ill., 2004) (“Under the section 404(a) duty of loyalty, ERISA fiduciaries must act ‘solely in the interest of plan participants and beneficiaries’ ... for the ‘exclusive purpose’ of providing benefits to them.”). *Id.* at 863.

¹⁴ “An essential feature and consequence of a fiduciary relationship is that the fiduciary becomes bound to act in the interests of her beneficiary and not of herself.” *In re Prudential Ins. Co. of America Sales Prac.*, 975 F.Supp. 584, 616 (D.N.J., 1996).

¹⁵ “[T]he Committee Reports indicate a desire to ... eliminate conflicts of interest between the investment adviser and the clients as safeguards both to ‘unsophisticated investors’ and to ‘bona fide investment counsel.’ The [IAA] thus reflects a ... congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser — consciously or unconsciously — to render advice which was not disinterested.” *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-2 (1963). “The IAA arose from a consensus between industry and the SEC that ‘investment advisers could not ‘completely perform their basic function — furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments — unless all conflicts of interest between the investment counsel and the client were removed.’” *Financial Planning Association v. Securities and Exchange Commission*, No. 04-1242 (D.C. Cir. 3/30/2007) (D.C. Cir., 2007) citing *SEC vs. Capital Gains* at 187.

conflict of interest¹⁶ and must ensure that the intelligent, independent and informed consent¹⁷ of his or her or its client is obtained with regard thereto. In any event, the proposed arrangement remains should be prudently managed in order that the client's best interests are preserved¹⁸ and that the proposed arrangement is substantively fair to the client.

¹⁶ “The overall statutory scheme of the IAA addresses the problems identified to Congress in two principal ways: First, by establishing a federal fiduciary standard to govern the conduct of investment advisers, broadly defined, *see Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11, 17 (1979), and second, by requiring full disclosure of all conflicts of interest.” *Financial Planning Association v. Securities and Exchange Commission*, No. 04-1242 at p.17 (D.C. Cir. 3/30/2007) (D.C. Cir., 2007). The existence of “federal fiduciary standard” under the Investment Advisers Act of 1940 does not mean that deference is not provided to the scope of fiduciary duties as they exist under state common law. *See U.S. v. Brennan*, 938 F.Supp. 1111 (E.D.N.Y., 1996) (“Other spheres in which the existence and scope of a fiduciary duty are matters of federal concern are ERISA and § 523(a)(4) of the Bankruptcy code. The analysis under each of these statutes continues to be informed by state and common law. *See, e.g., Varsity v. Howe*, ___ U.S. ___, ___, 116 S.Ct. 1065, 1070, 134 L.Ed.2d 130 (1996); *F.D.I.C. v. Wright*, 87 B.R. 1011 (D.S.D. 1988) (bankruptcy).”) *Id.* at 1119.

¹⁷ The fiduciary duty to avoid conflicts of interest, and the necessity to obtain the informed consent of the client as to conflicts of interest not avoided, were well known in the early history of the Advisers Act. In an address entitled “The SEC and the Broker-Dealer” by Louis Loss, Chief Counsel, Trading and Exchange Division, U.S. Securities and Exchange Commission on March 16, 1948, before the Stock Brokers’ Associates of Chicago, the fiduciary duties arising under the Advisers Act, as applied in the *Arleen Hughes* release, were elaborated upon:

The doctrine of that case, in a nutshell, is that a firm which is acting as agent or fiduciary for a customer, rather than as a principal in an ordinary dealer transaction, is under a much stricter obligation than merely to refrain from taking excessive mark-ups over the current market. Its duty as an agent or fiduciary selling its own property to its principal is to *make a scrupulously full disclosure of every element of its adverse interest in, the transaction.*

In other words, when one is engaged as agent to act on behalf of another, the law requires him to do just that. *He must not bring his own interests into conflict with his client's. If he does, he must explain in detail what his own self-interest in the transaction is in order to give his client an opportunity to make up his own mind whether to employ an agent who is riding two horses.* This requirement has nothing to do with good or bad motive. In this kind of situation the law does not require proof of actual abuse. The law guards against the potentiality of abuse which is inherent in a situation presenting conflicts between self-interest and loyalty to principal or client. As the Supreme Court said a hundred years ago, the law ‘acts not on the possibility, that, in some cases the sense of duty may prevail over the motive of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty.’ Or, as an eloquent Tennessee jurist put it before the Civil War, the doctrine ‘has its foundation, not so much in the commission of actual fraud, but in that profound knowledge of the human heart which dictated that hallowed petition, ‘Lead us not into temptation, but deliver us from evil,’ and that caused the announcement of the infallible truth, that ‘a man cannot serve two masters.’”

This time-honored dogma applies equally to any person who is in a fiduciary relation toward another, whether he be a trustee, an executor or administrator of an estate, a lawyer acting on behalf of a client, an employee acting on behalf of an employer, an officer or director acting on behalf of a corporation, an investment adviser or any sort of business adviser for that matter, or a broker. The law has always looked with such suspicion upon a fiduciary's dealing for his own account with his client or beneficiary that it permits the client or beneficiary at any time to set aside the transaction without proving any actual abuse or damage. What the recent Hughes case does is to say that such conduct, in addition ‘to laying the basis for a private lawsuit, amounts to a violation of the fraud provisions under the securities laws: This proposition, as a matter of fact, is found in a number of earlier Commission opinions. The significance of the recent Hughes opinion in this respect is that it elaborates the doctrine and spells, out in detail exactly what disclosure is required when a dealer who has put himself in a fiduciary position chooses to sell his own securities to a client or buys the client's securities in his own name ...

The nature and extent of disclosure with respect to capacity will vary with the particular client involved. In some cases use of the term ‘principal’ itself may suffice. In others, a more detailed explanation will be required. In all cases, however, the burden is on the firm which acts as fiduciary to make certain that the client understands that the firm is selling its own securities ...

[*Emphasis added.*]

¹⁸ *See, generally, Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438 (Bankr. S.D.N.Y., 1994) (“The [fiduciary] relationship requires that [the fiduciary must not] exert influence or pressure upon the other or take selfish advantage of the trust in such a way as to benefit himself or prejudice the [client]. A breach of fiduciary duty has occurred when influence has been acquired and abused and when confidence has been reposed and retained.”)

The fiduciary duty of loyalty – i.e., the duty to act in a client’s best interests – has three separate components. Under English law, from which American law is derived, the broad fiduciary duty of loyalty includes these three separate rules:

The “No Conflict” Rule: A fiduciary must not place itself in a position where its own interest conflict with those of its client.

The “No Profit” Rule: A fiduciary must not profit from its position at the expense of the client. This aspect of the fiduciary duty of loyalty is often considered a prohibition against self-dealing. Under the heading, “Duty of Loyalty,” the Second Restatement of Trusts states that the fiduciary “is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do. Similarly, the Second Restatement of Agency provides that the duty of loyalty entails a duty not to make a profit on transactions conducted for the principal or deal with the principal as an adverse party.

The “Undivided Loyalty” Rule: A fiduciary owes undivided loyalty to its client and therefore must not place itself in a position where his or her duty toward one client conflicts with a duty that it owes to another client.

The role of “informed consent” must be fully understood, if the “best interests” of the client are to be maintained. The informed consent of the client to proceed with a transaction recommended by a fiduciary advisor in the presence of a conflict of interest would rarely be given by an informed client if the conflict of interest were not managed to keep the best interests of the client paramount at all times; *clients rarely undertake gratuitous transfers to their financial advisors.*

Hence, courts appear to often find that there was not full disclosure, or that it was not affirmatively undertaken, or that the terms of the transaction were not fair, where the voluntary nature of the consent, or the understanding by the client of the material facts, is suspect. Such cases often arise in the similar instance where there is a great disparity in the knowledge between the provider of advice and the client - the attorney-client relationship. *See, e.g. Schenk v. Hill, Lent & Troescher*, 530 N.Y.S.2d 486, 487 (N.Y. Sup. Ct. 1988) (A lawyer hired to sue another lawyer for malpractice was himself a potential defendant in the same action, and obtained client consent to waive the conflict of interest. In disqualifying the lawyer, the court said: “[T]he consent obtained in this case does not reflect a full understanding of the legal rights being waived ... [T]he unsophisticated client, relying upon the confidential relationship with his lawyer, may not be regarded as able to understand the ramifications of the conflict, however much explained to him.”)

Proposed Reg BI is an incorrect, and harmful, attempt to redefine the English language. The term “best interests” has always been an expression of the fiduciary duty of loyalty. For a more detailed examination of this truism, see **EXHIBIT A** to this letter, **“BEST INTERESTS” MEANS “FIDUCIARY” !!!**

While proposed Regulation Best Interests states, in its very name, that it applies a “best interests” standard, upon close examination this is not the case. Even the name of the proposed rule is misleading!

The requirement under “Regulation Best Interests” to actually act in the best interests of a customer found in paragraph (a)(1) is easily avoided by broker-dealers, by simply applying the terms of the safe harbor language contained in paragraph (a)(2) of the proposal:

§ 240.15l-1 Regulation Best Interest.

(a) Best Interest Obligation.

(1) A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, shall act in the best interest of the retail customer at the time the

recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.

(2) The best interest obligation in paragraph (a)(1) shall be satisfied if:

(i) Disclosure Obligation. The broker, dealer, or natural person who is an associated person of a broker or dealer, prior to or at the time of such recommendation, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation.

(ii) Care Obligation. The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation exercises reasonable diligence, care, skill, and prudence to:

(A) Understand the potential risks and rewards associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;

(B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation; and

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile.

(iii) Conflict of Interest Obligations.

(A) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations.

(B) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

As seen above, nothing in the safe harbor [subsection (a)(2)] includes the requirement in section (a)(1) that the recommendation be "without placing the financial or other interest of the broker, dealer, ... ahead of the interest of the retail customer." Subsection (a)(2) simply requires only the following:

In (a)(2)(i), only the disclosure of a conflict of interest is required by a broker-dealer. As discussed previously in this comment letter, disclosures have limited effectiveness as a means of consumer protection.

In (a)(2)(iii)(A), all that is required is the adoption of procedures is required by a broker-dealer, and all that is required is the procedures to (at a minimum) disclose a conflict of interest. Again, such disclosure is only one step, of many, that is required of a true fiduciary.

In (a)(2)(iii)(B), all that is required is the adoption of procedures “reasonably designed” to “identify and disclose and mitigate” conflicts of interest “arising from financial incentives.” Yet:

There is no actual requirement to mitigate conflicts of interest – only to adopt procedures “reasonably designed” to mitigate.

Rather than impose the obligations that arise under the fiduciary duty of loyalty when a conflict of interest is present – affirmative disclosure of the conflict of interest, ensuring client understanding, obtaining informed consent, and even then that the transaction be substantively fair to the client – the proposed rule only requires an ambiguous requirement to adopt procedures to “mitigate” – and “mitigate” is not defined in the proposed rule!

The “financial incentives” – are those only of the registered representatives, or does this apply to the entire broker-dealer firm? Another ambiguity in the rule!

In essence, the safe harbor swallows, and eviscerates, the key language of Reg BI.

While the SEC sets out an example of how a higher-cost, and higher-remuneration, fund could not be recommended over a lower-cost one, there is nothing in the actual language of the safe harbor that compels this conclusion - because of the lack of the non-inclusion of the language "without placing the interest of ..." in the safe harbor itself. In fact, much of the discussion in the Release contains rather flowery pronouncements of what the proposed Reg BI requires – but Reg BI does not actually impose much in the way of obligations at all!

It is hard to understand what proposed Reg BI actually requires, in addition to the existing obligations imposed upon brokers today!

It is very hard to see how broker-dealers’ conduct standards are changed in any substantive manner!

Additionally, unlike the fiduciary duty arising under the Advisers Act and state common law, nothing in the actual language of proposed Reg BI prevents the broker from disclaiming its obligations, nor from seeking the customers to waive their rights. The concepts of waiver and estoppel, which have limited application to a fiduciary relationship, appear to be fully capable of being applied here upon any obligations imposed by Reg BI (if any such obligations were in fact imposed).

In essence, proposed Regulation Best Interests does not impose any substantial obligations on brokers that they don’t already possess. All it does is permit brokers to *advertise and promote* that they act in the “best interest” of their customers, *when such is not the case*. Brokers would be permitted, under Regulation Best Interests, to engender trust, and then to betray that trust, while not being held to anything close to the bona fide fiduciary standard of conduct.

Furthermore, even though disclosures are mandated, under fiduciary law there exists a substantial body of established law stating that fiduciaries must undertake affirmative disclosure of all material facts – and the ramifications to the client of a conflict of interest. Form CRS fails to require brokers to “bare the truth” when a conflict of interest is present. Yet, under the long-existing *bona fide* best interests standard applicable to fiduciaries, disclosure must “bare the truth ... in all its stark significance”; disclosure that a conflict of interest may, or does, exist, is wholly insufficient. As stated by the late great Justice Benjamin Cardozo: “If dual interests are to be served, the disclosure to be effective must lay bare the truth, without ambiguity of reservation, in all its stark significance” *Wendt v. Fischer*, 243 N.Y. 439, 154 N.E. 303 (1926). *See also In re Src Holding Corp.*, 364 B.R. 1 (D. Minn., 2007): “The fact that the client knows of a conflict is not enough to satisfy the attorney's duty of full disclosure. *See also Florida Ins. Guar. Ass'n Inc. v. Carey Canada, Inc.*, 749 F.Supp. 255, 259 (S.D.Fla.1990) (“Consent can only come after consultation – which the rule contemplates as full disclosure....”

[I]t is not sufficient that both parties be informed of the fact that the lawyer is undertaking to represent both of them, but he must explain to them the nature of the conflict of interest in such detail so that they can understand the reasons why it may be desirable for each to [withhold consent]." (quoting *Unified Sewerage Agency, Etc. v. Jeko, Inc.*, 646 F.2d 1339, 1345-46 (9th Cir.1981)); see also *British Airways, PLC v. Port Authority of N.Y. and N.J.*, 862 F.Supp. 889, 900 (E.D.N.Y.1994) (stating that the burden is on the client's attorney to fully inform and obtain consent from the client); see also *Kabi Pharmacia AB v. Alcon Surgical, Inc.*, 803 F.Supp. 957, 963 (D.Del.1992) (stating that evidence of the client's constructive knowledge of a conflict would not be sufficient to satisfy the attorney's consultation duty); see also *Manoir-Electroalloys Corp. v. Amalloy Corp.*, 711 F.Supp. 188, 195 (D.N.J.1989) ("Constructive notice of the pertinent facts is not sufficient."). A client is not responsible for recognizing the conflict and stating its lack of consent in order to avoid waiver. See also *Manoir-Electroalloys*, 711 F.Supp. at 195. ("The lawyer bears the duty to recognize the legal significance of his or her actions in entering a conflicted situation and fully share that legal significance with clients.")

In essence, Form CRS permits "casual disclosures" of conflicts of interest to occur. There is no laying bare, in proposed Form CRS, of the many adverse consequences that can – and often do – flow, from the presence of a conflict of interest.

This pervasive lack of a proper understanding by the Commission of the legal obligations flowing from the long-established *best interest* legal standard – *i.e.*, the *fiduciary duty of loyalty* – is of particular concern. Again, please refer to Appendix A hereto.

The Commission's proposed regulatory approach in Regulation Best Interest is premised on the assumption that investors can make an informed choice between different types of financial professionals operating under differing standards of conduct. Yet, the unavoidable conclusion from RAND's in-depth interviews is that, even after carefully reviewing Form CRS in a controlled setting, investors do not sufficiently understand the differences in the types of accounts and service providers to be able determine which would be the best option for them. Many participants failed to understand the differences between account types and financial professionals from the beginning, never fully grasping it.

The RAND Report reveals that the Commission should fundamentally rethink its regulatory approach. Given the evidence that, after being provided a summary relationship disclosure, investors still cannot fully understand, and in some cases misunderstand, fundamental differences in the nature of the brokerage and advisory relationships and the respective duties they are owed, the different fees they would pay, or how various conflicts of interest can influence the recommendations they receive, a regulatory regime that relies on disclosure for investors to make an informed decision about what type of financial professional to work with and what type of account to use is certain to fail.

E. The Commission's economic analysis behind proposed Form CRS and Reg BI is fundamentally flawed. Capital formation will be deterred and U.S. economic growth will be harmed if these proposed regulations are adopted.

It must be asked, "What is 'trust'?" And why is trust so important in the modern society of today?

There exists "at least implicitly accepted a definition of trust as a belief, attitude, or expectation concerning the likelihood that the actions or outcomes of another individual, group or organization will be acceptable ... or will serve the actor's interests."¹⁹

¹⁹ Sim B. Sitkin & Nancy L. Roth, Explaining the Limited Effectiveness of Legalistic "Remedies" for Trust/Distrust, 4 ORG. SCI. 367, 368 (1993).

Trust itself is also crucial to a society's economic success. Nobel laureate economist Kenneth Arrow has stated that “[v]irtually every commercial transaction has within itself an element of trust,” and that “much of the economic backwardness in the world can be explained by the lack of mutual confidence.”²⁰

Several studies have documented the positive relationship between trust in society and economic growth. Increased trust between actors in commercial transactions has a direct positive and significant effect on income *per capita* growth.²¹ It is well documented that public trust is positively correlated with economic growth.²²

Moreover, public trust is also correlated with participation by individual investors in the stock market.²³ This is especially true for individual investors with low financial capabilities – who in our society are in most need of financial advice; policies that affect trust in financial advice seem to be particularly effective for these investors.²⁴

The lack of trust in our financial system has potential long-range and severe adverse consequences for our capital markets and our economy. As stated by Prof. Ronald J. Colombo:

Trust is a critical, if not the critical, ingredient to the success of the capital markets (and of the free market economy in general). As Alan Greenspan once remarked: ‘[O]ur market system depends critically on trust—trust in the word of our colleagues and trust in the word of those with whom we do business.’ From the inception of federal securities legislation in the 1930s, to the Sarbanes-Oxley Act of 2002, to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, it has long been understood that in the face of economic calamity, the restoration and/or preservation of trust—especially investor trust—is paramount in our financial institutions and markets.”²⁵

There is no doubt that “[t]rust is a critically important ingredient in the recipes for a successful economy and a well-functioning financial services industry. Due to scandals ranging in nature from massive incompetence to massive irresponsibility to massive fraud; investor trust is in shorter supply today than just a couple of years ago. This is troubling, and commentators, policymakers, and industry leaders have all recognized the need for trust's restoration”²⁶

The imposition of fiduciary obligation facilitates the efficient allocation of resources by protecting the beneficiary of the fiduciary relationship from overreaching by the provider of services. Typically, that provider

²⁰ Kenneth Arrow, *Gifts and Exchanges*, 1 *Philosophy & Pub. Affairs* 343, 357 (1972).

²¹ See, e.g., Tatsu, Eirini and Zafar, Tasneem, *Social Capital and Economic Growth: Evidence from OECD Countries* (May 1, 2011).

²² Putnam, R., 1993, *Making Democracy Work: Civic Traditions in Modern Italy*, Princeton University Press, Princeton, NJ.; La Porta R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, 1997, “Trust in Large Organizations,” *American Economic Review*, 87, 333-338.

In an influential paper, Knack and Keefer found that a country's level of trust is indeed correlated with its rate of growth. Knack, S. and Keefer, P. (1996). “Does social capital have an economic payoff?: A cross country investigation,” *The Quarterly Journal of Economics*, vol 112, p.p 1251. See also Zak, P., and S. Knack, 2001, “Trust and Growth,” *The Economic Journal*, 111, 295-321.

²³ Guiso, L., P. Sapienza, and L. Zingales, 2007, “Trusting the Stock Market,” Working Paper, University of Chicago.

²⁴ Georgarakos, Dimitris and Inderst, Roman, *Financial Advice and Stock Market Participation* (February 14, 2011). ECB Working Paper No. 1296. Available at SSRN: <http://ssrn.com/abstract=1761486>.

²⁵ Ronald J. Colombo, *Trust and the Reform of Securities Regulation*, 35 *Del. J. Corp. L.* 829 (2010).

²⁶ *Id.* at 875. Prof. Colombo further observed: “Increased regulation of broker-dealers is likely to do little harm, as it is unclear whether sufficient room for high-quality, affective/generalized trust exists here in the first place. And if, in the twenty-first century, the brokerage industry relies upon primarily cognitive and specific trust (due to increased movement toward the discount-broker business model), such increased regulation could be beneficial.” *Id.* at 876. Prof. Colombo explained the concept of cognitive trust: “Reliance and voluntary exposure to vulnerability stemming from cognitive trust is not based upon emotions or norms, but rather ‘upon a cost-benefit analysis of the act of trusting someone.’ For this reason, Williamson rejects even calling such reliance ‘trust.’ To him, such reliance is a form of calculativeness, which serves to economize on the scarcity of one's mental energies and time. The potential vulnerabilities accepted are not due to ‘trust,’ but to rational risk management—to the fact that ‘the expected gain from placing oneself at risk to another is positive.’” *Id.* at 836.

is a professional who specializes in the provision of that service. The specialization of function forces individuals to rely on others to produce goods and services on fair terms. That reliance has necessarily afforded the opportunity for specialists to act in a self-interested fashion at the expense of the client by using their superior knowledge or skills. Accordingly, the fiduciary standard is applied to minimize the transaction costs of regulating specialized exchanges. To promote the efficiency gains of specialization, society imposes special regulations on occupational groups having the greatest latitude to drive hard bargains, such as those in confidential relationships with clients. The activities of the fiduciary are, therefore, policed by imposing certain duties upon the specialist-fiduciary; these duties are imposed to avoid the inefficiencies resulting from specialist overreaching. Accordingly, the fiduciary's duty of loyalty requires the fiduciary to follow the course of conduct the beneficiary would have chosen if the beneficiary had either the same expertise as the fiduciary or had consulted another fiduciary.

Fiduciary duties are imposed by law when public policy encourages specialization in particular services, such as investment advisory services or legal services, in recognition of the value such services provide to our society.

The premise of the U.S. capital markets is that the widest possible participation in the market will result in the most efficient allocation of financial resources and, therefore, will lead to the best operation of the world-wide economy. Putting the client first actually protects and promotes the best interests of the entire financial community, and, therefore, society as a whole. The concept is operationalized by requiring that financial professionals place the interests of their clients ahead of all other concerns. Responsibilities to employers, colleagues and selves are all placed in a descending order of importance. Those who have their trust betrayed often refuse to further participate in the capital markets, to their own financial peril and to the detriment of the nation's economy.

Moreover, many economic studies have demonstrated that Wall Street's excesses impair U.S. economic growth and the formation of new businesses and jobs. As just one example:

[F]inancialization depresses entrepreneurship. Paul Kedrosky and Dane Stangler of the Kauffman Foundation find that as financialization increases, startups per capita decrease, in part because the growth in the financial sector has distorted the allocation of talent. They estimate that if the sector were to shrink as a share of GDP back to the levels of the 1980s, *new business formation would increase by two to three percentage points*. We have substantial circumstantial evidence to show that these trends have had negative consequences at the macro level: *'the influence of finance sector size on economic growth turns negative when financial services become too large a share of an economy and that high levels of financial activity crowd out investment and R&D in the non-finance sector.'*" (Emphasis added.)²⁷

By failing to consider the long-term harm that will result to the U.S. economy from the compounding effects of lower accumulations of capital by retirement investors, the Commission has failed to comply with the economic analysis requirements of the Administrative Procedures Act.

Additionally, the proposed rules impose economic harm on fiduciary providers of investment advice. In essence, consumers will over time possess even less trust in financial advisors, leading to lesser utilization of fiduciary investment advisers, of which I am one. Hence, the rule does the emerging profession of investment advice, and the emerging profession of personal financial planning, great harm.

²⁷ Brookings Institute report by William A. Galston and Elaine C. Kamarck. "More builders and fewer traders: A growth strategy for the American economy." Available at <https://www.brookings.edu/research/more-builders-and-fewer-traders-a-growth-strategy-for-the-american-economy/>

It must be understood that the issue of investor trust in financial intermediaries does not just concern asset managers and Wall Street's broker-dealer firms; it affects all investment advisers and financial planners to individual clients. As Tamar Frankel, a leading scholar on U.S. fiduciary law, observed:

I doubt whether investors will commit their valuable attention and time to judge the difference between honest and dishonest ... financial intermediaries. I doubt whether investors will rely on advisors to make the distinction, once investors lose their trust in the market intermediaries. From the investor's point of view, it is more efficient to withdraw their savings from the market.²⁸

Individuals need to trust that the specialists they rely upon will keep their best interests at heart. The imposition of broad fiduciary duties of due care, loyalty, and utmost good faith promotes this essential relationship of trust. It permits entry into the capital markets by those without the knowledge and skill to navigate their complex waters. As stated by one of the most important social theorists of the 20th Century, the late Niklas Luhmann:

Trust is necessary in order to face the unknown, whether that unknown is another human being, or simply the future and its contingent events. Seldom, if ever, can we obtain all the information we would need in order to take decisions in a completely rational manner. At a certain point in our 'intelligence-gathering' about the world we have to call a halt, say 'enough is enough' and take a decision based on what we know and the way we feel. That decision will inevitably partly be based on trust. Trust is thus a way of reducing uncertainty. It lies somewhere between hope and confidence, and involves an element of semi-calculated risk-taking. Trust, by the reduction of complexity, discloses possibilities for action which would have remained unattractive and improbable without trust - which would not, in other words, have been pursued.²⁹

I have personally seen the trust of consumers betrayed, over and over again, by providers of financial and investment advice who act out of their own self-interest, and who are not bound by a bona fide fiduciary standard of conduct and the true obligation thereunder to act in the best interests of the client. Immense personal harm results, involving the destruction of the hopes and dreams of the consumer.

For society the cost of abuse of trust in the provision of investment advice is even greater. I have personally observed consumers, burned by brokers (who called themselves "financial advisers" but who operated in arms-length relationships with their customers under the low suitability standard), and then unwilling to trust any other financial or investment adviser, flee from the capital markets – likely for all time. Like most of the Greeks, such consumers resort to placement of their savings in commercial banks. As a result, the costs of capital increase for business enterprises, for the capital markets are deprived of direct funding. The provision of available equity capital, in particular, is diminished.

Investment advisory services rendered in a relationship of trust and confidence, as a fiduciary, encourage participation by investors in our capital markets system, which in turn promotes economic growth. The first and overriding responsibility any financial professional has is to all of the participants of the market. This primary obligation is required in order to maintain the perception³⁰ and reality that the market is a fair game and thus encourage the widest possible participation in the capital allocation process. The premise of the U.S. capital market is that the widest possible participation in the market will result in the most efficient allocation of

²⁸ Tamar Frankel, "Regulation and Investors' Trust in the Securities Markets," 68 Brook. L. Rev. 439, 448 (2002).

²⁹ Niklas Luhmann, TRUST AND POWER (John Wiley & Sons; Chichester, 1979), p. 4.

³⁰ "Applying the Advisers Act and its fiduciary protections is essential to preserve the participation of individual investors in our capital markets. NAPFA members have personally observed individual investors who have withdrawn from investing in stocks and mutual funds due to bad experiences with registered representatives and insurance agents in which the customer inadvertently placed his or her trust into the arms-length relationship." Letter of National Association of Personal Financial Advisers (NAPFA) dated March 12, 2008 to David Blass, Assistant Director, Division of Investment Management, SEC re: Rand Study.

financial resources and, therefore, will lead to the best operation of the U.S. and worldwide economy. Indeed, academic research has revealed that individual investors who are unable to trust their financial advisors are less likely to participate in the capital markets.³¹

Additionally, it is important to fiduciary advisors to be able to distinguish themselves from non-fiduciaries. A recent example of the problems faced by investment advisers was the “fee-based brokerage accounts” final rule adopted by the SEC in 2005, which would have permitted brokers to provide the same functional investment advisory services as investment advisers but without application of fiduciary standards of conduct. This would have negated to a large degree the economic incentives³² for persons to become investment advisers and be subject to the higher standard of conduct. The SEC’s fee-based accounts rule was overturned in *Financial Planning Ass’n v. S.E.C.*, 482 F.3d 481 (D.C. Cir., 2007).

The Commission now seeks to have broker-dealers, the sellers of securities, become believed by consumers to be trusted advisors under Reg BI, which the reality is that such is not the case. The Commission seeks to permit broker-dealers represent themselves to their customers as acting in a customer’s “best interests” – when in fact there is no legal obligation for brokers and registered representatives to act in the customer’s best interest, under a fiduciary duty of loyalty or as that term is commonly understood in the current English language. This will result in great harm to investment advisers and financial planners who operate under a fiduciary standard of conduct, as their role – truly acting with a strong fiduciary duty of due care (as an expert) and with a strong fiduciary duty of loyalty (in the actual “best interests” of their clients, not an illusionary “best interests” duty under Reg BI. As George Akerloff explained in his 1970 article for which he won the Nobel Prize in Economics: “[T]he presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business. The cost of dishonesty, therefore, lies not only in the amount by which the purchaser is cheated; the cost also must include the loss incurred from driving legitimate business out of existence.”³³

³¹ “We find that trusting individuals are significantly more likely to buy stocks and risky assets and, conditional on investing in stock, they invest a larger share of their wealth in it. This effect is economically very important: trusting others increases the probability of buying stock by 50% of the average sample probability and raises the share invested in stock by 3.4 percentage points ... lack of trust can explain why individuals do not participate in the stock market even in the absence of any other friction ... [W]e also show that, in practice, differences in trust across individuals and countries help explain why some invest in stocks, while others do not. Our simulations also suggest that this problem can be sufficiently severe to explain the percentage of wealthy people who do not invest in the stock market in the United States and the wide variation in this percentage across countries.” Guiso, Luigi, Sapienza, Paola and Zingales, Luigi. “Trusting the Stock Market” (May 2007); ECGI - Finance Working Paper No. 170/2007; CFS Working Paper No. 2005/27; CRSP Working Paper No. 602. Available at SSRN: <http://ssrn.com/abstract=811545>.

³² One might reasonably ask why “honest investment advisers” (to use the language of the U.S. Supreme Court in *SEC vs. Capital Gains*) had to be protected by the Advisers Act. Was it not enough to just protect consumers? The answer can be found in economic principles, as set forth in the classic thesis for which George Akerlof won a Nobel Prize:

There are many markets in which buyers use some market statistic to judge the quality of prospective purchases. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller. As a result there tends to be a reduction in the average quality of goods and also in the size of the market.

George A. Akerloff, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, *The Quarterly Journal of Economics*, Vol. 84, No. 3. (Aug., 1970), p.488.

George Akerloff demonstrated “how in situations of asymmetric information (where the seller has information about product quality unavailable to the buyer), ‘dishonest dealings tend to drive honest dealings out of the market.’ Beyond the unfairness of the dishonesty that can occur, this process results in less overall dealing and less efficient market transactions.” Frank B. Cross and Robert A. Prentice, *The Economic Value of Securities Regulation*, 28 *Cardoza L.Rev.* 334, 366 (2006).

³³ George A. Akerloff, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, *The Quarterly Journal of Economics*, Vol. 84, No. 3. (Aug., 1970), p.495.

F. The Commission, should it proceed with Form CRS and Reg BI, will be aiding and abetting a massive fraud upon consumers, and Chair Clayton and any Commissioners supporting these regulations will cause the U.S. Securities and Exchange Commission to become the laughing stock of the regulatory world and the least effective of all national and state regulators.

In 1934, the late Justice Harlan Stone explained the need for fiduciary capitalism, stating: “I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that ‘a man cannot serve two masters.’”³⁴

It must be recognized that no fiduciary can successfully wear two hats, and act as both trusted adviser and seller/distributor of products at the same time. To do so invites a breach of one’s fiduciary duty, whether consciously or unconsciously undertaken. Time and again our courts and commentators have cautioned against trying to represent two interests. As stated seventy years ago by the late Professor Louis Loss, when he served as the SEC’s Chief Counsel of its Trading and Exchange Division:

[W]hen one is engaged as agent to act on behalf of another, the law requires him to do just that. He must not bring his own interests into conflict with his client’s. If he does, he must explain in detail what his own self-interest in the transaction is in order to give his client an opportunity to make up his own mind whether to employ an agent who is riding two horses. This requirement has nothing to do with good or bad motive. In this kind of situation the law does not require proof of actual abuse. The law guards against the potentiality of abuse which is inherent in a situation presenting conflicts between self-interest and loyalty to principal or client. As the Supreme Court said a hundred years ago, the law ‘acts not on the possibility, that, in some cases the sense of duty may prevail over the motive of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty.’ Or, as an eloquent Tennessee jurist put it before the Civil War, the doctrine ‘has its foundation, not so much in the commission of actual fraud, but in that profound knowledge of the human heart which dictated that hallowed petition, ‘Lead us not into temptation, but deliver us from evil,’ and that caused the announcement of the infallible truth, that ‘a man cannot serve two masters.’³⁵

The Commission, through its proposed Reg BI and as exacerbated by a nonsensical, ineffective proposed Form CRS disclosure document that only obfuscates the distinctions between those who can be trusted and those who cannot, stands on the precipice of violating the centuries-old fiduciary principle. The Commission seeks to create a mere illusion for consumers that brokers act in the “best interests” of their customers, when in fact Reg BI imposes no fiduciary duty of loyalty whatsoever, and in fact imposes no significant restraint on brokers’ conduct. The Commission ignores the infallible truth that a broker-dealer is in a seller-customer, arms-length relationship with its customer. Furthermore, the Commission fails to observe that undeniable truth, first pronounced millennia ago, that a man cannot serve two masters.

I urge the Commission to reverse course, and to abandon its proposed Reg BI and Form CRS. The Commission should recognize that these proposed regulations do no good, and in fact will do great harm – to our fellow Americans, to companies by depriving them of increased capital and raising the cost of capital, and to the American economy itself.

³⁴ Stone H.F., Address to the University of Michigan School of Law on June 15, 1934, reprinted in the Harvard Law Review (1934).

³⁵ Speech, The SEC and the Broker-Dealer, by Louis Loss, Chief Counsel, Trading and Exchange Division, before Stock Brokers’ Associates of Chicago (March 16, 1948).

Chair Clayton, in the SEC's press release in November 2018 that announced the RAND Corporation's study, stated: "The results of RAND Corporation's investor testing support our efforts to provide retail investors with a clear and concise Relationship Summary to help them make important decisions about choosing to work with an investment professional." But the reality is not as Chair Clayton portrays it. The RAND Corporation study notes *substantial confusion* among those who participated in the *controlled* surveys as to *key issues* that prevent Form CRS from being effective. Worse, Form CRS will only create more confusion among investors and cause great harm – to individual investors / consumers, to professionals who already act in a fiduciary capacity, to capital formation, to American business who depend upon individual investors to supply capital, and to the American economy.

The reality is this – if it walks like an ugly duck and swims like a ugly duck and quacks like an ugly duck, that bird is and must be a duck. The reality from the RAND Corporation report – that Form CRS is deeply flawed, as is Reg BI upon which Form CRS is based, cannot be ignored. Chair Clayton cannot, simply through pronouncement, recharacterize the somber findings of the RAND Corporation's report into the conclusion that Form CRS is a workable solution, when the report reveals the stark truth of its fundamental flaws. *Chair Clayton cannot turn this particular ugly duck into a swan. No person can.*

I further urge the Commission to not become the laughing-stock of regulators, both within the U.S. and abroad, as it will most certainly will become should it enact these proposed regulations. The U.S. Securities and Exchange Commission was once thought to be the most effective of our regulatory agencies; that was decades ago, it is no more.

The Commission, should it proceed to adopt Form CRS, despite overwhelming knowledge of its deep flaws, ineffectiveness, and dangers for individual Americans and for America itself, stands on the precipice of becoming irrelevant as an effective regulator of the capital markets.

The Commission, should it proceed to adopt Reg BI and Form CRS, will undertake actions that will possess immense blowback from the public, and this may well lead to the Commission's own demise in favor of a different and far more effective regulator. Any capital markets regulator that chooses to ignore truth, which pays for studies but fails to learn from them, that moves to adopt rules that will cause great harm to the capital markets and consumers and the American economy, cannot long stay in existence, and deserves to be replaced. It is not my wish that the U.S. Securities and Exchange Commission be abolished, but should it move to finalize Reg BI and Form CRS despite the overwhelming truth that these regulations are completely inadequate, and despite knowledge of the great harm these regulations will cause, the Commission will set itself further down the path of irrelevance and will hasten calls for its demise.

Thank you for your consideration of my concerns.

I am available to provide additional information and observations, as the Commission may request from time to time.

Respectfully yours,

Ron A. Rhoades, JD, CFP®

Contact via email: [REDACTED]

APPENDIX A:

“BEST INTERESTS” MEANS “FIDUCIARY” !!!

I provide extensive recitations of authority on this point:

1. *The phrase “best interests” (as utilized, in its context, “best interests of the consumer”) is a phrase that has been reserved under the law for a fiduciary-client relationship, not a salesperson-customer relationship. The proposed modifications incorporating such a “best interests” standard without the imposition of bona fide fiduciary obligations is wholly inappropriate.*

1.1. “Acting in One’s Best Interests” is the Phrase Utilized to Describe Fiduciary Obligations to Lay Persons in Language They Better Understand.

1.1.1. The phrase “act in the best interests of the client” is used to explain, in language a non-lawyer would understand, the core aspect of the fiduciary duty of loyalty as well as elements of the fiduciary obligation of due care and utmost good faith.

1.1.1.1. Lay persons would be misled into relying upon an insurance producer who is selling particular products, even though the lay person (consumer) is not afforded the protections of a bona fide fiduciary standard. Lay persons understand the term “best interests” to apply to advisers whom they can trust.³⁶

1.1.1.2. The regulatory permission effectively granted to brokers and their registered representatives (salespersons) under the proposed Regulation BI - to utilize a phrase such as “I am bound by regulation to act in your ‘best interest’s” – when there is no actual requirement to adhere to a fiduciary obligation and the relationship remains one in which the customer does not receive the protections of fiduciary law - would cause tremendous harm to consumers.

1.1.1.3. In essence, consumers would believe that they could rely upon an insurance salesperson’s advice, given the regulatory approval of the use of the term “best interests” by salespersons, and such reliance by consumers would certainly be justified in such a circumstance. In essence, consumers would be lulled into thinking that they could rely upon the recommendations provided, when in fact such is not the case. As a result, such consumers would seldom undertake the efforts they should to protect their own interests, such as seeking out additional knowledge about the annuities

³⁶ It has long been a concern that lay consumers often place trust in non-fiduciary actors in financial services, even when such trust is not merited, due in major part to how broker-dealer firms and their registered representatives now hold themselves out and promote themselves, and the increased scope of the advice which they provided. *See Recommendation of the Investor as Purchaser Subcommittee: Broker-Dealer Fiduciary Duty (U.S. Securities and Exchange Commission, 2012):* “Because federal regulations have not kept pace with changes in business practice, broker-dealers and investment advisers are subject to different legal standards when they offer advisory services. Those legal standards – a suitability standard for broker-dealers and a fiduciary duty for investment advisers – afford different levels of protection to the investors who rely on those services. Key differences include the requirements that investment advisers, as fiduciaries, act in the best interests of their clients and appropriately manage and fully disclose conflicts of interest that could bias their recommendations. Investors typically make no distinction between broker-dealers and investment advisers, and most are unaware of the different legal standards that apply to their advice and recommendations. Although many investors don’t understand the meaning of “fiduciary duty,” or know whether it or suitability represents the higher standard, *investors generally treat their relationships with both broker-dealers and investment advisers as relationships of trust and expect that the recommendations they receive will be in their best interests” [Emphasis added.]*

recommended or seeking second opinions or alternative proposals from other insurance producers.

- 1.1.1.4. Consumers should not be forced to investigate, in order to discern whether those who hold themselves out as acting in their best interests, as fiduciaries, actually do so.³⁷
- 1.1.1.5. Simply put, because under the proposed model regulation an insurance producer could state that she or he acts in the “best interests” of the customer, when in fact no duty of loyalty nor substantially enhanced duty of due care (to the level of a true fiduciary) exists, consumers will have reasonably placed their trust and confidence in the insurance producer even though, in effect, an arms-length relationship still exists.
- 1.1.2. The term “best interests” has an established legal meaning, which COMMISSION should not seek to alter.
 - 1.1.2.1. *Black's Law Dictionary* (10th ed. 2014) defines a fiduciary duty as "a duty to act with the highest degree of honesty and loyalty toward another person and in the *best interest* of the other person") (*emphasis added*).
 - 1.1.2.2. The meaning of “best interests” as indicative of the fiduciary relationship is universal in other common law countries. As the joint judgment of McHugh, Gummow, Hayne and Callinan JJ explained in *Pilmer v Duke Group*, a decision from Australia, it is the “pledge” (undertaking) by one party to act in the best interests of the other which makes fiduciary relationships distinct from other relationships.³⁸
 - 1.1.2.3. The Commission’s proposal to utilize the term “best interests,” short of imposing a bona fide fiduciary obligation, would undermine centuries of legal precedent.
 - 1.1.2.4. The Commission’s proposal would therefore fail to heed the warnings of the late Justice Benjamin Cardoza, who so famously wrote: “Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions [citation omitted]. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.”³⁹
 - 1.1.2.5. The Commission’s proposal, if adopted, would change the definition of “best interests” – representing a significant erosion of an established definition that is

³⁷ As the SEC staff stated in its 2011 Study, “Retail investors are relying on their financial professional to assist them with some of the most important decisions of their lives. Investors have a reasonable expectation that the advice that they are receiving is in their best interest. They should not have to parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations.” SEC Staff, Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, January 2011 (available here: <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>).

³⁸ *Pilmer v The Duke Group (in Liq)* (2001) 207 CLR 165, [70]-[71]. See also *Norberg v Wynrib*, [1992] 2 S.C.R. 226 at 230 [Canada], per McLachlin J: “The essence of a fiduciary relationship... is that one party exercises power on behalf of another and pledges himself or herself to act in the best interests of the other.”

³⁹ *Meinhard vs. Salmon*, 164 N.E. 545 (N.Y. 1928).

currently understood by jurists, financial advisors, and consumers to refer to the key legal obligations of a fiduciary.

- 1.1.2.5.1. Such a change in the definition of “best interests” could result in an erosion of the duties owed to those who are fiduciaries in other contexts – such as those who undertake to care for incompetent or dependent people (such as children or infants), attorneys who represent the important legal interests of their clients in a variety of contexts, and the duties of trustees toward their beneficiaries.
- 1.1.2.5.2. The Commission should not seek to degrade the long-established obligations of bona fide fiduciaries by ignoring centuries of legal understanding, and lay understanding, of the term “best interests.”

1.2. Understanding the Two Different Forms of Commercial Relationships Under the Law: “Who’s On Top”? There exist two fundamentally different forms of commercial relationship in the law: the salesperson-customer relationship, and the fiduciary-entrustor (or fiduciary-client) relationship. These relationships are completely different under the law, and stark distinctions exist between the legal duties of the various parties in these relationships. Understanding fiduciary duties begins with an understanding of the two general types of relationships between product and service providers and their customers or clients under the law – “arms-length relationships” and “fiduciary relationships.”⁴⁰

1.2.1. Even with enhanced safeguards afforded to consumers such as enhanced disclosure obligations, the arms-length relationship of the parties involved in the sale of an investment or insurance product can still be described as:

PRODUCT MANUFACTURER(S)

⇓

MANUFACTURERS’ (SALES) REPRESENTATIVES

⇓

CUSTOMER

1.2.2. The fiduciary relationship is altogether different. The fiduciary acts as a “purchaser’s representative” – *i.e.*, on behalf of the client. The fiduciary “steps into the shoes of the client” and acts as if the client would act for himself/herself – but armed with the knowledge, skill, experience and hence expertise that the fiduciary possesses and is required to apply prior to making any recommendations to the client. The fiduciary relationship can be modeled as follows:

⁴⁰ “The legal system provides for only two levels of trust and their differentiation is necessary for them to be useful tools for parties setting up relationships ... In essence, legal systems provide only two levels of loyalty between contracting parties, arm's-length and fiduciary relationships. The difference in the degree of trust that the two levels of loyalty entitle the parties is dramatic. Fiduciary relations impose a pure duty of loyalty, according to which the fiduciary must place the interests of his employer before his own. Arm's-length relations, by contrast, allow exploitation within the parameters of good faith.” Georgakopoulos, Nicholas L., “Meinhard v. Salmon and the Economics of Honor” (April 1998, revised Feb. 8, 1999). Available at SSRN: <http://ssrn.com/abstract=81788> or DOI: 10.2139/ssrn.81788.

CLIENT



FIDUCIARY (PURCHASER'S OR CLIENT'S REPRESENTATIVE)



PRODUCT MANUFACTURERS

1.2.3. Enhancements to required disclosures do not turn those in arms-length relationships into fiduciary actors. While disclosures can be an important consumer protection, much academic research has revealed the limits to their effectiveness. Because disclosures are so often ineffective as a means of protecting consumers, the law applies the protections of the fiduciary relationship in situations where public policy so dictates.

1.3. Arms-Length Relationships: Actual Fraud is Prohibited; Additional Obligations May Be Imposed by Law Short of Fiduciary Obligations. “Arms-length” relationships apply to the vast majority of service provider–customer engagements.⁴¹ In other words, non-fiduciaries who contract with each other can engage in “conduct permissible in a workaday world for those acting at arm's length.”⁴²

1.3.1. In arms-length relationships, the doctrine of *caveat emptor*⁴³ generally applies,⁴⁴ although there are many exceptions made to this doctrine in which enhanced disclosure obligations arise, mandated contractual forms exist, or even certain products are prohibited. For example, even state common law compels affirmative disclosure of adverse material facts in diverse contexts.⁴⁵

1.3.2. In arms-length, commercial relationships, the level of trust or confidence reposed by the customer in the other party is not exceptional. “Mere subjective trust does not transform

⁴¹ See, for example, *Hartman v. McInnis*, No. 2006-CA-00641-SCT (Miss. 11/29/2007) ([O]rdinarily a bank does not owe a fiduciary duty to its debtors and obligors under the UCC ... the power to foreclose on a security interest does not, without more, create a fiduciary relationship ... a mortgagee-mortgagor relationship is not a fiduciary one as a matter of law.”). “[T]he significant weight of authority holds that franchise agreements do not give rise to fiduciary ... relationships between the parties.” *GNC Franchising, Inc. v. O'Brien*, 443 F.Supp.2d 737, 755 (W.D. Pa., 2006).

⁴² *Meinhard v. Salmon*, 249 NY 458, 464 (N.Y. 1928).

⁴³ *Caveat emptor* is Latin for ‘Let the buyer beware.’ In its purest form at common law, in the absence of fraud, misrepresentation or active concealment, the seller is under no duty to disclose any defect; it therefore provides a safe harbor to a seller to not to disclose any information to a buyer. See Alex M. Johnson, Jr., “An Economic Analysis Of The Duty To Disclose Information: Lessons Learned From The Caveat Emptor Doctrine” (2007), available at <http://law.bepress.com/cgi/viewcontent.cgi?article=9154&context=expresso>. It means that a customer should be cautious and alert to the possibility of being cheated. The doctrine supports the idea that buyers take responsibility for the condition of the items they purchase and should examine them before purchase. This is especially true for items that are not covered under any warranty. See, e.g. *SEC v. Zandford*, 535 U.S. 813 (2002).

⁴⁴ “When parties deal at arm's length the doctrine of caveat emptor applies, but the moment that the vendor makes a false statement of fact, and the falsity is not palpable to the purchaser, he has an undoubted right to implicitly rely upon it. That would indeed be a strange rule of law which, when the seller has successfully entrapped his victim by false statements, and was called to account in a court of justice for his deceit, would permit him to escape by urging the folly of his dupe was not suspecting that he (the seller) was a knave.” *Holcomb v. Zinke*, 365 N.W.2d 507, 511 (N.D., 1985).

⁴⁵ It is well settled that fraud may occur without the making of a false statement. *Dvorak v. Dvorak*, 329 N.W.2d 868 (N.D.1983). The suppression of a material fact, which a party is bound in good faith to disclose, is equivalent to a false representation. *Very v. Murphy*, 163 N.W.2d 721 (N.D.1969).

arms-length dealing into a fiduciary relationship.”⁴⁶ “Absent express agreement of the parties⁴⁷ or extraordinary circumstances, however, parties dealing at arms-length in a commercial transaction lack the requisite level of trust or confidence between them necessary to give rise to a fiduciary obligation.”⁴⁸ Ordinary “buyer-seller relationships” do not give rise to the imposition of fiduciary duties upon the seller.⁴⁹

- 1.3.3. Yet, it must be recognized that *commercial good faith* is always required in contract performance. Actors in arms-length relationships are always subject to the requirement of “mere good faith and fair dealing”⁵⁰ in the performance of their obligations; this doctrine is

⁴⁶ *Exxon Corp. v. Breezevale Ltd.*, 82 S.W.3d 429 (Tex. App., 2002).

⁴⁷ *Pension Committee v. Banc of America Securities*, 592 F.Supp.2d 608, 624 (S.D.N.Y., 2009) (“a fiduciary relationship may arise where the parties to a contract specifically agree to such a relationship . . .”).

⁴⁸ *Pension Committee v. Banc of America Securities*, 592 F.Supp.2d 608, 624 (S.D.N.Y., 2009) (“no fiduciary duties arise where parties deal at arm’s length in conventional business transaction”); *Henneberry v. Sumitomo Corp. of America*, 415 F.Supp.2d 423, 460 (S.D.N.Y., 2006), citing *Nat’l Westminster Bank, U.S.A. v. Ross*, 130 B.R. 656, 679 (S.D.N.Y.1991) (“Where parties deal at arms length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary circumstances.” (citing, *inter alia*, *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 738-39 (2d Cir.1984); *Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, N.A.*, 731 F.2d 112, 122 (2d Cir. 1984))), *aff’d*, *Yaeger v. Nat’l Westminster*, 962 F.2d 1 (2d Cir.1992) (table); *Beneficial Commercial Corp. v. Murray Glick Datsun, Inc.*, 601 F.Supp. 770, 772 (S.D.N.Y. 1985) (“[C]ourts have rejected the proposition that a fiduciary relationship can arise between parties to a business transaction.” (citing *Grumman Allied Indus., Inc.*, 748 F.2d at 738-39; *Wilson-Rich v. Don Aux Assocs., Inc.*, 524 F.Supp. 1226, 1234 (S.D.N.Y.1981); *duPont v. Perot*, 59 F.R.D. 404, 409 (S.D.N.Y.1973)); *WIT Holding Corp. v. Klein*, 282 A.D.2d 527, 724 N.Y.S.2d 66, 68 (App.Div.2001) (“Under these circumstances, where the parties were involved in an arms-length business transaction involving the transfer of stocks, and where all were sophisticated business people, the plaintiff’s cause of action to recover damages for breach of fiduciary duty should have been dismissed.”).

⁴⁹ *In re Prudential Ins. Co. of America Sales Prac.*, 975 F.Supp. 584 (D.N.J., 1996), where, in a case involving sales by life insurance agents of variable appreciable life insurance products as “investment plans,” the court stated: “An essential feature and consequence of a fiduciary relationship is that the fiduciary becomes bound to act in the interests of her beneficiary and not of herself. Obviously, this dynamic does not inhere in the ordinary buyer-seller relationship. Thus, ‘the efforts of commercial sellers — even those with superior bargaining power — to profit from the trust of consumers is not enough to create a fiduciary duty. If it were, the law of fiduciary duty would largely displace both the tort of fraud and much of the Commercial Code.’ *Committee on Children’s Television, Inc., v. General Foods Corp.*, 35 Cal.3d 197, 221, 197 Cal.Rptr. 783, 789, 673 P.2d 660, 675 (1983) (en banc).” *In re Prudential Ins. Co. of America Sales Prac.* At 616.

⁵⁰ See *GNC Franchising, Inc. v. O’Brien*, 443 F.Supp.2d 737, 755 (W.D. Pa., 2006) (“A party bound by a fiduciary duty must advance the interests of the *cestui que* trust above its own and act scrupulously in the other’s interests. Imposition of this degree of duty—*i.e.*, selfless service as opposed to merely good faith and fair dealing—would generally be inapplicable as between parties to a commercial relationship knowingly entered into for each party’s own profit”).

In arms-length relationships, the burden of proof of lack of fair dealing rests on the person alleging that the other party acted in such manner. This contrasts with the burden of proof where a fiduciary relationship exists, where the burden of proof of fair dealing rests with the fiduciary. See *ABN Amro Mortgage Group, Inc. v. Pristine Mortgage, LLC*, No. CV 04-4005389 (CT 9/8/2005) (CT, 2005) (“The significance of the establishment of a fiduciary relationship is twofold. First, the burden of proving fair dealing shifts to the fiduciary. Secondly, the standard of proof for establishing fair dealing is not the ordinary standard of fair preponderance of evidence but requires proof of clear and convincing evidence.”)

fundamental to all commercial transactions.⁵¹ Good faith requires that each party perform their respective obligations and enforce their rights honestly and fairly.⁵²

- 1.3.4. While there is no general duty to disclose material facts in arms-length transactions, actual or “common law” fraud is prohibited in the formation of commercial relationships. There is generally no duty to undertake full disclosure of material facts in the negotiation of commercial contracts,⁵³ except where one party’s superior knowledge renders non-disclosure of an essential fact inherently unfair⁵⁴ or a “special relationship” exists.⁵⁵ Instead, actors in commercial relationships generally possess a duty to undertake diligent inquiry in order to ascertain facts.⁵⁶ However, if disclosures are undertaken by a party, the statements

⁵¹ The doctrine of good faith requires that the parties also perform their respective obligations and enforce their rights honestly and fairly. See Restatement (Second) Contracts (1981) at §205, “Duty of Good Faith and Fair Dealing,” stating: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.” The *Comment* to this section adds: “Good faith is defined in Uniform Commercial Code § 1-201(19) as ‘honesty in fact in the conduct or transaction concerned.’ ‘In the case of a merchant’ Uniform Commercial Code §2-103(1)(b) provides that good faith means ‘honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.’ The phrase ‘good faith’ is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness or reasonableness. Failure to abide by the duty of good faith may constitute fraud (in the event of intentional misrepresentation) or breach of contract.”

⁵² For example, the Uniform Commercial Code, adopted by every state except Louisiana, explicitly imposes a good faith obligation on the performance and enforcement of every contract falling within its scope. UCC § 1-304, as amended (2003). Essentially, the Restatement of Contracts adopts the view that “bad faith in performance” is a violation of the good faith obligation. As stated by Professor Emily S.H. Hough: “The subcategories of bad faith in performance further delineated by Summers include ‘evasion of the spirit of the deal,’ ‘lack of diligence and slacking off,’ ‘willfully rendering only ‘substantial performance,’ ‘abuse of power to determine compliance,’ and ‘interfering with or failing to cooperate in the other party’s performance.’” All of these subcategories contemplate cases in which judges would feel comfortable using their discretionary and equitable powers to find a breach of good faith where the express language of the contract might not otherwise support a claim for breach of contract.” Hough, Emily, “The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?” Utah Law Review, 2005. Available at SSRN: <http://ssrn.com/abstract=622982>.

⁵³ See *Southern Intermodal Logistics, Inc. v. Smith & Kelly Co.*, 190 Ga.App. 584, 379 S.E.2d 612, 613-4 (1989) (“While concealment of material facts may amount to fraud when the concealment is of intrinsic qualities the other party could not discover by the exercise of ordinary care ... in an arms-length business or contractual relationship there is no obligation to disclose information which is equally available to both parties”).

⁵⁴ *Henneberry v. Sumitomo Corp. of America*, 415 F.Supp.2d 423 (S.D.N.Y., 2006), stating: “Even absent the existence of a fiduciary relationship, however, a party’s duty to disclose a material fact to another party it is negotiating with is triggered where ‘one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge.’ *Grumman Allied Indus., Inc.*, 748 F.2d at 739 (quoting *Aaron Ferer & Sons Ltd.*, 731 F.2d at 123; *Jana L. v. W. 129th St. Realty Corp.*, 22 A.D.3d 274, 802 N.Y.S.2d 132, 134 (App.Div.2005) (‘It is well established that, absent a fiduciary relationship between the parties, a duty to disclose arises only under the ‘special facts’ doctrine ‘where one party’s superior knowledge of essential facts renders a transaction without disclosure inherently unfair.’ (quoting *Swersky v. Dreyer & Traub*, 219 A.D.2d 321, 643 N.Y.S.2d 33, 37 (App.Div. 1996).” *Henneberry* at 461.

⁵⁵ See *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 881 (9th Cir., 2007) (“Nevada also recognizes “special relationships” giving rise to a duty to disclose, such that ‘[n]ondisclosure . . . become[s] the equivalent of fraudulent concealment.’ *Mackintosh v. Jack Matthews & Co.*, 109 Nev. 628, 855 P.2d 549, 553 (1993). In order to prove the existence of a special relationship, a party must show that (1) ‘the conditions would cause a reasonable person to impart special confidence’ and (2) the trusted party reasonably should have known of that confidence. *Mackintosh v. Cal. Fed. Sav. & Loan Ass’n*, 113 Nev. 393, 935 P.2d 1154, 1160 (1997) (per curiam). ‘[T]he existence of the special relationship is a factual question . . .’ *Id.*)

⁵⁶ See *Burger King Corp. v. Austin*, 805 F.Supp. 1007, 1019 (S.D. Fla., 1992) (“Florida law additionally charges a claimant with knowledge of all facts that he could have learned through diligent inquiry ... In absence of a fiduciary relationship, mere nondisclosure of material facts in an arm’s length transaction is ordinarily not actionable misrepresentation unless some artifice or trick has been employed to prevent the representee from making further independent inquiry, though non-disclosure of material facts may be fraudulent where the other party does not have an equal opportunity to become appraised of the facts.”), citing *Taylor v. American Honda Motor Co.*, 555 F.Supp. 59, 64 (M.D.Fla.1982).

made must be truthful and complete⁵⁷ or actual fraud⁵⁸, also called “common law fraud,” exists. And, while commercial good faith does not automatically extend to the area of contract negotiations, misrepresentations made during the formation of a contract may constitute either actual fraud or breach of contract.⁵⁹ To put it much more simply, don’t lie, cheat, deceive or steal – even in commercial arms-length relationships.

- 1.4. No fiduciary obligations exist in most arms-length relationships. “An arms-length relationship can support no implied-in-law fiduciary obligations.”⁶⁰
 - 1.4.1. The standard of conduct expected of the actors in arms-length relationships has been described by the courts as the “morals of the marketplace.”⁶¹
 - 1.4.2. In contrast, the fiduciary obligation is much more than the duties found for actors in arms-length relationships. Professor Deborah DeMott asserts that “[t]he fiduciary’s duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary’s best interests.”⁶²
- 1.5. Fiduciary-entrustor (i.e., fiduciary-client) relationships are completely different from arms-length relationships; the fiduciary represents not the seller of a product, but rather the client alone. The other type of relationship is the fiduciary-entrustor relationship. In this type of relationship the provider of services (either management of assets, or the provision of advice) adopts a wholly different role. The fiduciary becomes bound by fiduciary duties of due care, loyalty and utmost good faith to the entrustor (the “client” in our context of investment or financial advice). The fiduciary, in essence, “steps into the shoes” of the client, and makes the decisions (or provides the

⁵⁷ See *Playboy Enterprises v. Editorial Caballero*, 202 S.W.3d 250, 260 (Tex. App., 2006), stating: “In addition to situations where there is a fiduciary or confidential relationship ... a duty to speak may arise in an arms-length transaction in at least three other situations: (1) when one voluntarily discloses information, he has a duty to disclose the whole truth; (2) when one makes a representation, he has a duty to disclose new information when the new information makes the earlier representation misleading or untrue; and (3) when one makes a partial disclosure and conveys a false impression, he has the duty to speak.”

⁵⁸ “Actual fraud is where one person causes pecuniary injury to another by intentionally misrepresenting or concealing a material fact which from their mutual position he was bound to explain or disclose.” Charles Sweet, *A Dictionary of English Law* (1883).

⁵⁹ Waller, Spencer Weber and Brady, Jillian G., “Consumer Protection in the United States: An Overview; Strengthening the Consumer Protection Regime” (2007), available at SSRN: <http://ssrn.com/abstract=1000226>. Private actions alleging actual fraud form an important, though often expensive and difficult, avenue for protection of the rights of a contracting party. “A consumer may file a lawsuit for deceit or fraud when a vendor intentionally conceals a material fact or makes a false representation of a material fact, knows that the representation is false, and meant to induce the consumer to act based on the misrepresentation. In order for the consumer to be successful in court, a plaintiff must also reasonably rely on the misrepresentation and suffer damage as a result of the reliance. Deceit can occur when a vendor makes a direct false statement, or when a misrepresentation is achieved through silence, concealment, half-truths, or ambiguity about a good. While misrepresentation of product facts may bring legal action, mere puffery and sales representative opinions are generally not subject to lawsuits for deceit.” *Id.* at p. 13.

⁶⁰ *Marine, Inc. v. Brunswick Corporation*, No. 07-13907 Non-Argument Calendar (11th Cir. 5/14/2008) (11th Cir., 2008) , at p.5; see *Taylor Woodrow Homes Florida, Inc. v. 4/46-A Corp.*, 850 So.2d 536, 541 Fla. 5th DCA 2003 (“When the parties are dealing at arm’s length, a fiduciary relationship does not exist because there is no duty imposed on either party to protect or benefit the other.”). See also *Greenberg v. Chrust*, 198 F.Supp.2d 578, 585 (S.D.N.Y., 2002) (“parties to arms length commercial contracts do not owe each other a fiduciary obligation”).

⁶¹ *In re Auto Specialties Mfg. Co.*, 153 B.R. 457, 488 (Bankr. W.D. Mich., 1993) (Courts have described the standard of conduct to which a non-fiduciary will be held in the vernacular as the ‘morals of the marketplace’”).

⁶² Deborah DeMott, “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) *Duke Law Journal* 879 at 888.

advice) as if the fiduciary was the client. In other words, the fiduciary is bound to act in the sole or best interests of the client.

1.6. Understanding the true nature of the fiduciary-client relationship.

- 1.6.1. The fiduciary standard of conduct flows from the requirement of the fiduciary “to adopt the principal’s goals, objectives, or ends.”⁶³ “It is what makes fiduciary law unique and separates fiduciaries from other service providers.”⁶⁴ As Professor Arthur Laby explained:

Some even use the phrase ‘alter ego’ to reference the fiduciary norm. This personalizes the duty in a particular way. The fiduciary must appropriate the objectives, goals, or ends of another and then act on the basis of what the fiduciary believes will accomplish them – a happy marriage of the principal’s ends and the fiduciary’s expertise. The fiduciary does not eliminate its own legal personality, rather it must consider the principal’s delegation of authority to the fiduciary from the perspective of fidelity to the principal’s objectives as the fiduciary understands them.⁶⁵

As further explained by Professor Laby, “What generally sets the fiduciary apart from other agents or service providers is a core duty, when acting on the principal’s behalf, to adopt the objectives or ends of the principal as the fiduciary’s own.”⁶⁶

- 1.6.2. In contrast to arms-length relationships, the law imposes upon one party to some relationships the status of a fiduciary. This form of relationship is called the “fiduciary relationship” or “fiducial relationship.” One upon whom fiduciary duties are imposed is known as the “fiduciary” and is said to possess “fiduciary status.” The fiduciary standard of conduct is consistently described by the courts as the “highest standard of duty imposed by law.”⁶⁷

⁶³ A fiduciary is “a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking.” RESTATEMENT (2^D) AGENCY § 13 comment (a) (1958). “[T]he general fiduciary principle requires that the agent subordinate the agent’s interests to those of the principal and place the principal’s interests first as to matters connected with the agency relationship.” RESTATEMENT (3^D) AGENCY § 8.01 cmt. b (2007). See also Laby, Arthur B., “The Fiduciary Obligation as the Adoption of Ends,” Buffalo L. Rev 99, 103 (2008), available at <http://ssrn.com/abstract=1124722>. See also *Varity Corp. v. Howe*, 516 U.S. 489, 116 S.Ct. 1065, 134 L.Ed.2d 130 (1996), in which the U.S. Supreme Court, applying ERISA, stated that: “There is more to plan (or trust) administration than simply complying with the specific duties imposed by the plan documents or statutory regime; it also includes the activities that are “ordinary and natural means” of achieving the “objective” of the plan. Bogert & Bogert, supra, § 551, at 41-52. Indeed, the primary function of the fiduciary duty is to constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime. If the fiduciary duty applied to nothing more than activities already controlled by other specific legal duties, it would serve no purpose.” *Id.* (*Emphasis added.*)

⁶⁴ Laby, *supra* n.65, at 130.

⁶⁵ Laby, *supra* n.65, at 135.

⁶⁶ Arthur B. Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act Of 1940*, 91 Boston Univ. L.Rev. 1051, 1055 (2011).

⁶⁷ See, generally BLACK’S LAW DICTIONARY 523 (7th ed. 1999) (“A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer’s client or a shareholder); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another.”); also see *F.D.I.C. v. Stahl*, 854 F.Supp. 1565, 1571 (S.D. Fla., 1994) (“Fiduciary duty, the highest standard of duty implied by law, is the duty to act for someone else’s benefit, while subordinating one’s personal interest to that of the other person); and see *Perez v. Pappas*, 98 Wash.2d 835, 659 P.2d 475, 479 (1983) (“Under Washington law, it is well established that ‘the attorney-client relationship is a fiduciary one as a matter of law and thus the attorney owes the highest duty to the

- 1.6.3. The term "fiduciary" comes to us from Roman law, and means "a person holding the character of a trustee, or a character analogous of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires."⁶⁸ Indeed, the Latin root of the word fiduciary – *fiduciarius* – means one in whom trust – *fiducia* – reposes. Legal usage in many jurisdictions also developed an overlay – an implication of a particular relationship of confidence between the fiduciary and those who had placed their trust in that person.
- 1.6.4. At the beginning of the nineteenth century, in *Gibson*, 31 Eng. Rep. 1044 (1801), the court, while explaining the decision to rescind the sale of an annuity by an attorney to his client, announced that “[one] who bargains in matter of advantage with a person placing confidence in him is bound to sh[o]w, that a reasonable use has been made of that confidence; a rule applying to trustees, attorneys or anyone else.” The courts eventually settled on “fiduciary” to denominate relationships of trust and confidence and denominated the doctrine (applied in *Gibson*) regulating these confidential relationships as “constructive fraud.” By the mid-nineteenth century, the doctrine of constructive fraud was said to arise from some peculiar confidential or fiduciary relation between the parties.
- 1.6.5. More recently, Justice Philip Talmadge of the State of Washington Supreme Court summarized the core aspects of current fiduciary relationships:
- A fiduciary relationship is a relationship of trust, which necessarily involves vulnerability for the party reposing trust in another. One's guard is down. One is trusting another to take actions on one's behalf. Under such circumstances, to violate a trust is to violate grossly the expectations of the person reposing the trust. Because of this, the law creates a special status for fiduciaries, imposing duties of loyalty, care, and full disclosure upon them. One can call this the fiduciary principle.⁶⁹
- 1.6.6. A breach of fiduciary duty constitutes “constructive fraud” under state common law.
- 1.6.6.1. To prove a breach of fiduciary duty, a plaintiff must show that he or she and the defendant had a fiduciary relationship, that the defendant breached its fiduciary duty to the plaintiff, and that this resulted in an injury to the plaintiff or a benefit to the defendant.
- 1.6.6.2. For example, in fiduciary relationships the failure to disclose material facts while seeking a release has been held to be actionable as fraudulent concealment. *See, e.g., Pacelli Bros. Transp. v. Pacelli*, 456 A.2d 325, 328 (Conn. 1982) (“the intentional withholding of information for the purpose of inducing action has been regarded ... as equivalent to a fraudulent misrepresentation.”); *Rosebud Sioux Tribe v. Strain*, 432 N.W.

client.”), cited by *Bertelsen v. Harris*, 537 F.3d 1047 (9th Cir., 2008); also see *Donovan v. Bienwirth*, 680 F. 2d 262, 272, n.8 (2nd Cir., 1982) (fiduciary duties are the “highest known to law”).

⁶⁸ BLACK'S LAW DICTIONARY, 5th Edition (1979)].

⁶⁹ *Von Noy v. State Farm Mutual Automobile Insurance Company*, 2001 WA 80 (WA, 2001) (J. Talmadge, concurring opinion).

2d 259, 263 (S.D. 1988) (“The mere silence by one under such a [fiduciary] duty to disclose is fraudulent concealment.”) (*Ibid.*)

- 1.6.6.3. Why does “fraud” occur in this context, where there is not an overt misrepresentation of a fact, but only an omission? “Where a fiduciary relationship exists, facts which ordinarily require investigation may not incite suspicion (*see, e.g., Bennett v. Hibernia Bank*, 164 Cal.App.3d 202, 47 Cal.2d 540, 560, 305 P.2d 20 (1956), and do not give rise to a duty of inquiry (*id.*, at p. 563, 305 P.2d 20). Where there is a fiduciary relationship, the usual duty of diligence to discover facts does not exist. *United States Liab. Ins. Co. v. Haidinger-Hayes, Inc.*, 1 Cal.3d 586, 598, 83 Cal.Rptr. 418, 463 P.2d 770 (1970)’ *Hobbs v. Bateman Eichler, Hill Richards, Inc.*, 210 Cal.Rptr. 387, 164 Cal.App.3d 174 (Cal. App. 2 Dist., 1974).
- 1.6.6.4. It is not necessary for the plaintiff to prove causation to prevail on claims of certain breaches of fiduciary duty. It is the agent’s disloyalty, not any resulting harm, that violates the fiduciary relationship.
- 1.6.7. “There is a crucial distinction between surrendering control of one's affairs to a fiduciary or confidant or party in a position to exercise undue influence and entering an arms length commercial agreement, however important its performance may be to the success of one's business.”⁷⁰ The “fiduciary relationship” is distinct from arms-length relationships, as those whom the law classifies as fiduciaries must carry on their dealings with beneficiaries at a level high above ordinary commercial standards.
- 1.6.8. Perhaps the most famous judicial expression of fiduciary duties is Justice Cardozo's famous lines expressing a lofty vision of the duties owed by fiduciaries. “Generations of corporate lawyers have been schooled in its memorable language finding broad fiduciary obligations on managers of other peoples' money.”⁷¹

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions [citation omitted]. Only thus has

⁷⁰ *Ettol, Inc. v. Elias/Savion Advertising, Inc.*, 811 A.2d 10, 23 (Pa. Super. Ct., 2002), stating: “Most commercial contracts for professional services involve one party relying on the other party's superior skill or expertise in providing that particular service. Indeed, if a party did not believe that the professional possessed specialized expertise worthy of trust, the contract would most likely never take place. This does not mean, however, that a fiduciary relationship arises merely because one party relies on and pays for the specialized skill or expertise of the other party. Otherwise, a fiduciary relationship would arise whenever one party had any marginally greater level of skill and expertise in a particular area than another party. Rather, the critical question is whether the relationship goes beyond mere reliance on superior skill, and into a relationship characterized by "overmastering influence" on one side or "weakness, dependence, or trust, justifiably reposed" on the other side. *Basile v. H & R Block*, 777 A.2d 95, 101 (Pa.Super.2001). A confidential relationship is marked by such a disparity in position that the inferior party places complete trust in the superior party's advice and seeks no other counsel, so as to give rise to a potential abuse of power.” *Id.*

⁷¹ Georgakopoulos, Nicholas L., *Meinhard v. Salmon and the Economics of Honor*(April 1998). Available at SSRN: <http://ssrn.com/abstract=81788> or DOI: 10.2139/ssrn.81788.

the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.⁷²

1.6.9. As Professor Langbein observed, “Courts have boasted of their “stubbornness and inflexibility,” their “[u]ncompromising rigidity,” in applying the sole interest rule.”⁷³

1.7. Advice providers are often fiduciaries. As Professor Arthur Laby notes, “Historically, providing advice has given rise to a fiduciary duty owed to the recipient of the advice. Both the *Restatement (First)* and *Restatement (Second) of Torts* state, “[a] fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation” [citing *Restatement (Second) Of Torts* § 874 cmt. a (1979) (citation omitted) (*emphasis added*); *Restatement (First) Of Torts* § 874 cmt. a (1939) (citation omitted) (*emphasis added*)].

1.8. The use of the term “best interests” is found in numerous judicial decisions to describe the duty of a fiduciary, not those of a salesperson. This use of the term “best interests,” primarily to describe the fiduciary duty of loyalty (the most distinguishing feature of the fiduciary principle), is found in numerous judicial decisions. This author’s recent search of a U.S. case law database revealed 963 judicial opinions in which the terms “fiduciary” and “best interests” appeared in the same decision. In addition, there are numerous decisions in other common-law countries, such as the United Kingdom and Australia, that also utilize the term “best interests” to describe the salient feature of the fiduciary obligation.

1.8.1. For example, one U.S. court, recently opining on ERISA’s fiduciary duty of loyalty, stated: “ERISA imposes a duty of loyalty on fiduciaries. *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir.), cert. denied, 459 U.S. 1069, 74 L. Ed. 2d 631, 103 S. Ct. 488 (1982) (Friendly, J.). A trustee violates his duty of loyalty when he enters into substantial competition with the interests of trust beneficiaries. *Restatement (Second) of Trusts*, § 170, comment p ... under the law of trusts, a fiduciary is generally prohibited, not just from acting disloyally, but also from assuming a position in which a temptation to act contrary to the *best interests* of the beneficiaries is likely to arise. *Grynberg* at 1319; 2 Scott on Trusts § 170, pp. 1297-98 (1967).”⁷⁴ [*Emphasis added.*]

1.8.2. In describing an attorney’s fiduciary duty of loyalty to a client, a court stated: “public policy requires that he not be subjected to any possible conflict of interest which may deter him from determining the best interests of the client ... a client's right to the undivided loyalty of

⁷² *Meinhard vs. Salmon*, 164 N.E. 545 (N.Y. 1928). “Justice Cardozo held that a nonmanaging partner could share in a deal that the owner of the property the partnership managed had offered to the managing partner although the deal would begin after the termination of the partnership's 20-year term and included significant property beyond what the partnership had managed. *Meinhard* provides a workable definition of fiduciary duties as requiring the obligated party to act with the ‘finest loyalty’ to the owner's interests.” Ribstein, Larry E., “The Structure of the Fiduciary Relationship” (January 4, 2003). U Illinois Law & Economics Research Paper No. LE03-003. Available at SSRN: <http://ssrn.com/abstract=397641> or DOI: 10.2139/ssrn.397641

⁷³ John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 Yale L.J. 929, 932 (March 2005). [*Emphasis added.*]

⁷⁴ *Salovaara v. Eckert*, 94 Civ. 3430 (KMW), U.S. D.C. SDNY, 1996 U.S. Dist. LEXIS 323 (1996).

his or her attorneys must be protected ... The duty of both the associate and the successor attorney is the same: to serve the *best interests* of the client."⁷⁵ [*Emphasis added.*]

- 1.8.3. For example, in explaining the duty of loyalty owed by a board of directors to the corporation, the instruction to a lay jury reads: "Each member of the ... board of directors is required to act in good faith and in a manner the director reasonably believes to be in the *best interests* of the corporation when discharging his or her duties."⁷⁶ [*Emphasis added.*]
- 1.8.4. In describing the fiduciary duty of the director of a corporation to the corporation and its shareholders, a court opined: "The duty of loyalty 'mandates that the *best interest* of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.' *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993) (citing *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984) and *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984)); see also *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913, 919 (Minn. 1944). The classic example is when a fiduciary either appears on both sides of a transaction or receives a substantial personal benefit not shared by all shareholders. *Id.*"⁷⁷ [*Emphasis added.*]
- 1.8.5. Similarly, "[t]he duty of loyalty requires that the *best interests* of the corporation and its shareholders take precedence over any self-interest of a director, officer, or controlling shareholder that is not shared by the stockholders generally."⁷⁸ [*Emphasis added.*]
- 1.8.6. Also, "[I]n dealing with corporate assets [the corporate officer] was required to act in the *best interests* of the corporation and he was prohibited from using either his position or the corporation's funds for his private gain."⁷⁹ [*Emphasis added.*]
- 1.8.7. While there have been many judicial elicitation of the fiduciary standard, more recent and concise recitation of the fiduciary principle can be found in dictum within the 1998 English (U.K.) case of *Bristol and West Building Society v. Matthew*, in which Lord Millet undertook what has been described as a "masterful survey" of the fiduciary principle:

A fiduciary is someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principle is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to

⁷⁵ *Beck v. Wecht*, No. S099665, Supreme Court Of California, 28 Cal. 4th 289; 48 P.3d 417; 121 Cal. Rptr. 2d 384; 2002 Cal. LEXIS 4197; 2002 Cal. Daily Op. Service 5812; 2002 Daily Journal DAR 7326 (2002).

⁷⁶ *Schultz v. Scandrett*, #27158, Supreme Court of South Dakota, 2015 SD 52; 866 N.W.2d 128; 2015 S.D. LEXIS 85 (June 24, 2015).

⁷⁷ *DQ Wind-Up, Inc. v. Kohler*, Court File No. 27-CV-10-27509, Minnesota District Court, County Of Hennepin, Fourth Judicial District, 2013 Minn. Dist. LEXIS 118 (2013).

⁷⁸ *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

⁷⁹ *Levin v. Levin*, 43 Md. App. 380, 390, 405 A.2d 770 (1979).

indicate the nature of the fiduciary obligations. They are the defining characteristics of a fiduciary.⁸⁰

1.9. Numerous law review articles and academic texts also reflect on the fiduciary's obligation to act in the client's (entrustor's) "best interests."

- 1.9.1. "Tracing this doctrine back into the womb of equity, whence it sprang, the foundation becomes plain. Wherever one man or a group of men entrusted another man or group with the management of property, the second group became fiduciaries. As such they were obliged to act conscientiously, which meant *infidelity to the interests of the persons* whose wealth they had undertaken to handle. In this respect, the corporation stands on precisely the same footing as the common-law trust." Adolf A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* 336 (1939). [*Emphasis added.*]
- 1.9.2. "The underlying purpose of the duty of loyalty, which the sole interest rule is meant to serve, is to advance *the best interest* of the beneficiaries ... There can be no quibble with the core policy that motivates the duty of loyalty. Any conflict of interest in trust administration, that is, any opportunity for the trustee to benefit personally from the trust, is potentially harmful to the beneficiary. The danger, according to the treatise writer Bogert, is that a trustee 'placed under temptation' will allow 'selfishness' to prevail over the duty to benefit the beneficiaries. 'Between two conflicting interests,' said the Illinois Supreme Court in an oft-quoted opinion dating from 1844, 'it is easy to foresee, and all experience has shown, whose interests will be neglected and sacrificed' ..." [*Emphasis added.*]
- 1.9.3. "The duty of loyalty requires a trustee 'to administer the trust solely in the interest of the beneficiary' ... The underlying purpose of the duty of loyalty, which the sole interest rule is meant to serve, is to advance the best interest of the beneficiaries ... The law is accustomed to requiring that attorneys zealously pursue their clients' interests and that they not indulge interests that may conflict with those of a particular client without first disclosing the potential conflict to the client and receiving the client's approval. There are some conflicts that cannot be overcome by the client's permission where the conflicted attorney would have to avoid the conflict entirely or quit the representation of the client. Law firms vigorously monitor potential conflicts between attorneys and clients. The rules of professional responsibility go to great lengths to define the appropriate standard of conduct for attorneys and describe what constitutes a conflict and how an attorney, law firm, and client should handle it. These strictly enforced standards of conduct cover every facet of the attorney-client relationship and leave very little to chance in a court's ex post determination of whether an attorney has breached her fiduciary duties. While fiduciary duties may apply to the relationship and zealous advocacy is clearly required, *the obligation an attorney owes a client is ... quite thoroughly described in codes of conduct that have grown ever more complete and sophisticated over time.*" John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 *Yale L.J.* 929 (March 2005). [*Emphasis added.*]

⁸⁰ *Bristol and West Building Society v Mothew* [1998] EWCA Civ 533.

1.10. The Commission has also utilized the term “best interests” frequently to describe the fiduciary obligation of investment advisers.

1.10.1. “An essential feature and consequence of a fiduciary relationship is that the fiduciary becomes bound to act in the interests of her beneficiary and not of herself.” *In re Prudential Ins. Co. of America Sales Prac.*, 975 F.Supp. 584, 616 (D.N.J., 1996).

1.10.2. In the SEC’s 2011 “Staff Study on Investment Advisers and Broker-Dealers - As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,” the SEC staff cited *Transamerica Mortgage Advisors, Inc.*, 444 U.S. 11, 17 (1979), stating: “The duty of loyalty requires an adviser to serve the best interests of its clients, which includes an obligation not to subordinate the clients’ interests to its own.”⁸¹

1.10.3. We also see the term “best interests” used to describe the legal obligations arising for those who provide personalized investment advice to retail customers. On January 22, 2011, the SEC’s Staff, fulfilling the mandate under §913 of the Dodd-Frank Act, released its Study on the regulation of broker-dealers and investment advisers. The overarching recommendation made in the Study is that the SEC should adopt a uniform fiduciary standard for investment advisers and broker-dealers that is no less stringent than the standard under the Advisers Act. Specifically, the Staff recommended the following: “[T]he 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 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.” SEC Staff, Study on Investment Advisers and Broker-Dealers ii (2011) [hereinafter SEC Staff Study], available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

1.10.4. In its 1940 Annual Report, the U.S. Securities and Exchange Commission noted:

If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject' to 'fiduciary duty. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States. Court of Appeals for the District of Columbia in a recently decided case: ‘[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who would deal at arm's length must stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and protector. He cannot commingle his trusteeship with merchandizing on his own account....

Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, at p. 158, citing *Earll v. Picken* (1940) 113 F. 2d 150.

1.10.5. The Commission also “has held that where a relationship of trust and confidence has been developed between a broker-dealer and his customer so that the customer relies on his advice, a fiduciary relationship exists, imposing a particular duty to act in the customer’s best interests and to disclose any interest the broker-dealer may have in transactions he

⁸¹ SEC Staff Study, dated Jan. 21, 2011, at p.22 (available at <http://sec.gov/news/studies/2011/913studyfinal.pdf>)

effects for his customer ... [broker-dealer advertising] may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business ... Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties.” 1963 SEC Study of the Securities Industry, citing various SEC Releases.

1.11. The U.S. Department of Labor’s “Conflict of Interest” and Related Prohibited Transactions Correctly Applied the Term “Best Interests,” but Its Method of Application was not Followed by the Commission.

1.11.1. The U.S. Department of Labor proposed to make substantive changes to PTE 84-24, which relates to the sale of fixed-interest annuity contracts (and, before the changes, to fixed indexed annuities). Most importantly, the proposal provided that, in order to qualify for the exemption, insurance and annuity agents must adhere to new “Impartial Conduct Standards.” 2015 Proposed PTE 84-24, 80 Fed. Reg. 22,010, 22,018 (Apr. 20, 2015). Under those standards, the insurance agent and insurance company would be required to act “in the best interest of the plan [or] IRA” and to ensure that statements about investment fees, material conflicts of interest, and other matters directly relevant to the investment decision are not misleading. *Id.* The Department further proposed that an insurance agent or insurance company would be deemed to “act in the '[b]est [i]nterest' of the plan or IRA” when “the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances and needs of the [p]lan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.” *Id.* at 22,020. These conditions parallel the duties of prudence and loyalty found in title I of ERISA. *See* 29 U.S.C. § 1104(a)(1).

1.11.2. The Commission’s proposal falls far short of the DOL’s imposition of Impartial Conduct Standards.

1.12. Industry Executives Acknowledged, in Sworn Testimony Before Congress, that the Term “Best Interests” Relates to the Obligation of Fiduciaries.

1.12.1. In a December 2, 2015 hearing before the Subcommittee On Health, Employment, Labor, And Pensions, of the U.S. House Education and Workforce Committee, Mr. Jules O. Gaudreau, Jr., ChFC, CIC testified, on behalf of the National Association of Insurance and Financial Advisors (NAIFA), under oath: “We already believe that we do engage in the best interests of our clients; we take an ethics pledge on their behalf.”⁸²

1.12.2. Subsequently, U.S. Representative Suzanne Bonomaci addressed testimony in an earlier hearing, noting that industry executives all responded affirmatively when she inquired, “Just

⁸² Hearing, video record at 1:14.

to be clear, does everyone agree that a ‘best interests’ standard means a ‘best interests’ fiduciary standard?”⁸³ Each of the industry executives then answered in the affirmative.

2. **FINRA’s various proposals to advance the use of “best interests” to essentially describe the suitability obligation of broker/dealer firms and their registered representatives, with a slight modification requiring “casual disclosure” of conflicts of interest, is both unfortunate and could cause great harm.**

“I am a stock and bond broker. It is true that my family was somewhat disappointed in my choice of profession.”

– Binx Bolling, *The Moviegoer* (1960)⁸⁴

- 2.1. The Commission’s proposed Regulation Best Interests derives substantially from proposals advanced by FSI and SIFMA, and then endorsed by FINRA, for a “best interests” standard of conduct for brokers, that is nothing more than suitability enhanced by casual disclosures.
- 2.2. These recent efforts by certain actors in the securities industry – including SIFMA and FSI (lobbyist organizations for broker-dealer firms) and FINRA (the self-regulator of broker-dealers, whose members are all broker-dealer firms) – continue to seek to redefine the fiduciary duty of loyalty as a weak disclosure-only requirement. These initiatives included, at first, a “new federal fiduciary standard” or “uniform standard of care,” which has more recently evolved into the advancement of a “best interests” standard that is, in reality, preserving only the profits and “best interests” of broker-dealer firms (and not the “best interests” of their clients). These proposals are contrary to centuries of developed law on fiduciary-client relationships and should be soundly rebuffed.
- 2.3. FINRA’s Efforts to Promote an Illusory “Best Interests” Standard: A Long Record of Deceit.
 - 2.3.1. FINRA and various lobbying firms for broker-dealer firms originally advanced a “best interests” standard. A great deception is occurring by this FINRA, along with brokerage lobbying organizations SIFMA and FSI. These organizations seek to re-define a centuries-old, strict legal standard to a new suitability regime, together with casual disclosure of conflicts of interest combined with securing the customer’s uninformed consent. In so doing, FINRA, which has long resisted the proper application of the fiduciary standard to the investment advice activities of brokers, endorses an exacerbation of consumer confusion as it seeks to further obfuscate the merchandizing role of broker-dealer firms.
 - 2.3.2. In touting a new “best interests” standard that falls far short of a true fiduciary standard of conduct, FINRA perpetuates a 75-year history of opposing the substantial raising of standards of conduct for brokerage firms and their registered representatives. In so doing, FINRA continues its long-standing failure to live up to the hopes of Senator Maloney, who once stated that his Maloney Act of 1938 (which led to the establishment of NASD, now

⁸³ Hearing, video record at 1:44.

⁸⁴ Walter Percy, *The Moviegoer* (New York: Ivy Books, 1960), pg. 6.

known as FINRA) had, as its purpose, “the promotion of truly professional standards of character and competence.”⁸⁵

- 2.3.3. It must be recognized that in the early 20th Century, FINRA’s suitability standard was originally designed to mitigate the duty of due care that all service providers possess, in recognition that a broker should not be liable for the default of a security merely for performing “trade execution” services.⁸⁶ Inexplicably, however, the suitability standard was expanded in the 1970’s to brokers’ recommendations of investment managers (including mutual fund providers). In turn this has led to a wide plethora of pooled investment vehicles, often expensive, and often with “hidden” revenue-sharing. The result has been widespread harm to investors, given the substantial academic research demonstrating the close relationship between high mutual fund fees and costs and lower returns. Moreover, individual Americans are unable to recover from brokers due to a breach of the duty of due care, since brokers do not possess such a duty – even though nearly every other service provider in the United States possesses such a duty.
 - 2.3.3.1. “Suitability” is a standard that is lower than the typical standard of due care seen by providers of services, such as plumbers, contractors, electricians, etc. Suitability does not require “due care.” For example, suitability does not generally require registered representatives to recommend a lower cost product with identical risk and return characteristics, if one is available.
 - 2.3.4. FINRA’s statements over the past few years have often been contradictory. FINRA stated to brokers in its earlier release regarding Rule 2111 that brokers’ recommendations must be consistent with the “best interests” of their customers. Yet, just last year, FINRA stated to the U.S. Department of Labor: “We recognize that imposing a best interest standard requires rulemaking *beyond what is presently in place for broker-dealers.*”⁸⁷ [*Emphasis added.*]
 - 2.3.5. In essence, FINRA has long sought to assure the public that protections exist under FINRA regulations, that simply don’t exist. In 2005, FINRA opposed the application of the Advisers Act’s fiduciary duties upon brokers who provided fee-based accounts, even though FINRA acknowledged that, “[f]rom a retail client’s perspective, the differences between investment advisory services and traditional brokerage services are almost imperceptible.”⁸⁸ Stating that “brokerage investors are fully protected”⁸⁹ FINRA even questioned the need for additional disclosures to investors. Also, in a widely criticized statement, FINRA also expressed in 2005

⁸⁵ Senator Francis T. Maloney, Regulation of the Over-the-Counter Security Markets, Address at the California Security Dealers Association, Investment Bankers Association, National Association of Securities Dealers 2 (Aug. 22, 1939) (transcript available in the SEC Library at 11 SEC Speeches, 1934-61).

⁸⁶ See, e.g. Arthur Laby, *Fiduciary Obligations of Broker-Dealers*, 55 Vill.L.Rev. 701, 733-4 (“Although brokers historically provided advice to their customers, advice rendered in the past was relatively less significant in the context of the overall relationship than it is today ... A history of the Merrill Lynch firm explains that, in the early part of the twentieth century, many brokerage firms did not do much more than execution—their sales forces were primarily intermediaries arranging trades on secondary markets—and the information available to investors seeking advice was rather meager. Open a modern description of the activities of broker-dealers and advice often is paramount.”) (*Citations omitted.*)

⁸⁷ FINRA Comment Letter to DOL, July 17, 2015, at p. 3.

⁸⁸ FINRA Comment Letter to U.S. Securities and Exchange Commission, July 11, 2005, re: “Certain Broker-Dealers Deemed Not to Be Investment Advisers,” Securities Exchange Act Release No. 40980; File No. S7-25-99, at p.2.

⁸⁹ *Id.* at p.5.

that the SEC’s proposed disclosure for fee-based accounts “implies that customer’s rights, the firm’s duties and obligations, and the applicable fiduciary obligations are greater with respect to an investment adviser account than they are with respect to a brokerage account. As we have previously discussed, this is simply not the case.”⁹⁰ FINRA’s statement is clearly erroneous, as everyone – and their mothers – agree that the fiduciary standard is a much higher standard than the suitability standard.

3. *The use of the term “best interests” in the regulation could lead to a finding of fiduciary status for broker-dealer firms and their registered representatives, under general principles of state common law, exposing them to a higher duty of due care, loyalty and utmost good faith and the potential liability resulting therefrom.*

3.1. The broad fiduciary duties of a broker or insurance agent toward his or her customer are more likely to be found by courts when a confidential relation exists, as may occur when personalized investment advice is provided. In the United States, our state courts have long applied broad fiduciary duties upon those in relationships of “trust and confidence” with entrustors. As stated by one early 20th Century court:

In equity the court looks to the relationship of the parties -- the reliance, the dependence of one upon the other. Where a relationship of confidence is shown to exist, where trust is justifiably reposed, equity scrutinizes the transaction with a jealous eye; it exacts the utmost good faith in the dealings between the parties, and is ever alert to guard against unfair advantage being taken by the one trusted.⁹¹

3.2. Under state common law it has long been recognized that the use of a title denoting an advisory role is a significant factor in determining that fiduciary status exists – even for insurance agents.

3.2.1. *Koehler, 1985.* A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, “The developer defendants obtained investment capital from the public by posing as financial planners ... The financial planners typically had a background in either insurance or real estate sales ... As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation... CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled ... At the seminars, CSCC offered to draft a ‘Coordinated Financial Plan’ for attendees at little or no charge. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project” The court also noted, “Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the

⁹⁰ *Id.*

⁹¹ *Jothann v. Irving Trust Company*, 151 Misc. 107; 270 N.Y.S. 721, citing *Wendt v. Fischer*, 215 A.D. 196; 213 N.Y.S. 351 (1926).

misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status.”

- 3.2.2. *Cunningham (1990)*. Insurance agents who introduced themselves as “investment counselors or enrollers” and who tailored retirement plans for each person depending on the individual’s financial position, and who led the customers to believe that an investment plan was being drafted for each customer according to each customer’s needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).
- 3.2.3. *Mathias (2002)*. “In the fall of 1985, plaintiff, having recently divorced and relocated to Columbus, Ohio, sought investment advice from Thomas J. Rosser. At the time, Rosser was a licensed salesman for Great Lakes Securities Company and held himself out as a financial advisor ... [T]he evidence established that Rosser was a licensed stockbroker and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship.” *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002). The court further noted, that under Ohio law, a fiduciary relationship is “a relationship in which one party to the relationship places a special confidence and trust in the integrity and fidelity of the other party to the relationship, and there is a resulting position of superiority or influence, acquired by virtue of the special trust.” *Id.*
- 3.2.4. *Williams (2006)*. In a case arising from Oregon, a self-employed insurance seller and licensed financial planner took advantage of his position as a financial advisor to gain the trust of an 87-year-old man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about \$400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a financial advisor and estate planner. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006).
- 3.2.5. *Hatleberg (2005)*. When a bank held out as either an “investment planner,” “financial planner,” or “financial advisor,” the Wisconsin Supreme Court held that a fiduciary duty may arise in such circumstances. *Hatleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005).
- 3.2.6. *Graben (2007)*. A dual registrant crossed the line in "holding out" as a financial advisor, and in stating that ongoing advice would be provided, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business

transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

4. *The Commission should take care to not mix two relationships under the law that so many jurists and commentators have opined simply cannot be reconciled: the fiduciary-entrustor relationship and the salesperson-customer relationship.*
 - 4.1. "The obligation of loyalty [understood as the obligation to act with the proper motive] is irreducible and cannot be put on a scale. It applies, or it does not, to a particular decision."⁹²
 - 4.2. As the Virginia Supreme Court long ago stated: "It is well settled as a general principle, that trustees, agents, auctioneers, and all persons acting in a confidential character, are disqualified from purchasing. The characters of buyer and seller are incompatible, and cannot safely be exercised by the same person. *Emptor emit quam minimo potest; venditor vendit quam maximo potest*. The disqualification rests, as was strongly observed in the [English] case of the *York Buildings Company v. M'Kenzie*, 8 Bro. Parl. Cas. 63, on no other than that principle which dictates that a person cannot be both judge and party. No man can serve two masters. He that it interested with the interests of others, cannot be allowed to make the business an object of interest to himself; for, the frailty of our nature is such, that the power will too readily beget the inclination to serve our own interests at the expense of those who have trusted us."⁹³
 - 4.3. The observation that a person cannot wear two hats and continue to adhere to his or her fiduciary duties was echoed early on by the U.S. Supreme Court, "The two characters of buyer and seller are inconsistent."⁹⁴ The U.S. Supreme Court also observed: "If persons having a confidential character were permitted to avail themselves of any knowledge acquired in that capacity, they might be induced to conceal their information, and not to exercise it for the benefit of the persons relying upon their integrity. The characters are inconsistent."⁹⁵
 - 4.4. Why should an advisor not attempt to wear two hats? Simply put, because persons are weak. Economic incentives matter a great deal, and drive a person's actual conduct. Persons are simply unable to not have their advice be affected by the economic temptations (such as for additional compensation) that might exist. As the U.S. Supreme Court opined in its landmark 1963 decision, *SEC vs. Capital Gains Research Bureau*, "the rule ... includes within its purpose the removal of any temptation to violate them ... This Court, in discussing conflicts of interest, has said: 'The

⁹² Lionel Smith, "The Motive Not the Deed", in *Rationalizing Property, Equity, and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis UK, 2003) 53 at 77.

⁹³ See, e.g., *Carter v. Harris*, 25 Va. 199, 204; (Va. 826). The U.S. common law is derived from the laws of England, which law continues to influence the development of U.S. law. In the cited early case, the English court stated: "the rule [prohibiting one from acting as both fiduciary and seller] was founded in reason and nature, and prevailed wherever any well-regulated administration of justice was known; that the disability rested on the principle which dictated that a person cannot be both judge and party, and serve two masters; that he who is intrusted with the interest of others, cannot be allowed to make the business an object to himself, because, from the frailty of human nature, one who has power will be too readily seized with an inclination to serve his own interest at the expense of those for whom he is intrusted; that the danger of temptation does, out of the mere necessity of the case, work a disqualification " nothing less than incapacity being able to shut the door against temptation, when the danger is imminent and the security against discovery great; that the wise policy of the law had therefore put the sting of disability into the temptation, as a defensive weapon against the strength of the danger which lies in the situation; that the parts which the buyer and seller have to act, stand in direct opposition to each other in point of interest; and this conflict of interest is the rock, for shunning which the disability has obtained its force, by making that person who has the one part intrusted to him, incapable of acting on the other side."

⁹⁴ *Wormley v. Wormley*, 21 U.S. 421; 5 L. Ed. 651; 1823 U.S. LEXIS 290; 8 Wheat. 421 (1823).

⁹⁵ *Michoud v. Girod*, 45 U.S. 503; 11 L. Ed. 1076; 1846 U.S. LEXIS 412; 4 HOW 503 (1846).

reason of the rule inhibiting a party who occupies confidential and fiduciary relations toward another from assuming antagonistic positions to his principal in matters involving the subject matter of the trust is sometimes said to rest in a sound public policy, but it also is justified in a recognition of the authoritative declaration that no man can serve two masters; and considering that human nature must be dealt with, the rule does not stop with actual violations of such trust relations, but includes within its purpose the removal of any temptation to violate them ... we [previously] said: “The objection ... rests in their tendency, not in what was done in the particular case ... The court will not inquire what was done. If that should be improper it probably would be hidden and would not appear.”⁹⁶

5. *The Commission’s use of the term “best interests” could potentially amount to the Commission’s endorsement of fraud.*
 - 5.1. The use of the term “best interests” implies duties encompassing due care, loyalty, honesty and integrity, and should not be utilized lightly. Nor should the term “best interests” be utilized as puffery. As Judge Paul Crotty recently cautioned: “Goldman's arguments in this respect are Orwellian. Words such as ‘honesty,’ ‘integrity,’ and ‘fair dealing’ apparently [in Goldman’s eyes] do not mean what they say; [Goldman says] they do not set standards; they are mere shibboleths. If Goldman's claim of ‘honesty’ and ‘integrity’ are simply puffery, the world of finance may be in more trouble than we recognize.”⁹⁷
 - 5.2. When we are dealing with the fiduciary standard of conduct, and its requirement that the fiduciary act in the “best interests” of the entrustor (client), we should not accept half-truths and deception. If the fiduciary standard is to possess meaning, we must hold firms and persons accountable to their words, and not regard these important words as mere “puffery.”
 - 5.3. The Commission’s improper use of the term “best interests” may well lead to an inadvertent government endorsement of, or the undertaking of, fraudulent misrepresentation. Section 525 of the Restatement (Second) of Torts provides the general rule for fraudulent misrepresentation: “One who fraudulently makes a misrepresentation of fact, opinion, intention, or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.”

To prove common law fraud in most states, the plaintiff must show that:

- the defendant made a material false representation or failed to communicate a material fact, which had the effect of falsifying statements actually made
- the defendant did this intentionally (the defendant knew that the representation or omission constituted a falsehood) or recklessly (the defendant made the representation without regard to whether it was true or false)
- the defendant intended that the plaintiff act on it
- the plaintiff did, in fact, rely on the representation or omission to his or her detriment.

⁹⁶ *SEC v. Capital Gains Research Bureau*, 375 U.S. 180; 84 S. Ct. 275; 11 L. Ed. 2d 237; 1963 U.S. LEXIS 2446 (1963) (citations omitted).

⁹⁷ Judge Paul Crotty in *Richman v. Goldman Sachs Group, Inc.*, 868 F. Supp. 2d 261 (S.D.N.Y. 2012).

A representation is material if either a substantial likelihood exists that a reasonable person would attach importance to it in making a decision or the person who made the representation has reason to know that the plaintiff is likely to regard it as important in making a decision, even though a reasonable person would not so regard it.

Fraudulent misrepresentation by omission may be actionable if the defendant has a duty to the plaintiff to disclose material facts and fails to do so, and if this failure results in a false impression being conveyed to the plaintiff.

- 5.4. This is a brazen, unjustified attempt by broker-dealer and insurance company organizations and their lobbyists to redefine the English language. The move by lobbying organizations SIFMA, FSI, and NAIFA, with FINRA's endorsement, to promote a new "best interests standard" is nothing more than a brazen, and somewhat bizarre, attempt to usurp the common understanding of both lay persons, as well as practitioners, attorneys, and jurists, by a wholly unjustified and imminently harmful redefinition of the term "best interests."
- 5.5. The use of the term "best interests" to describe a standard of conduct that falls far short of the fiduciary obligation would amount to fraud, as all of the elements of fraud would be present:
- a material false representation of a material fact (by falsely advancing the belief that an insurance producer would act in the customer's "best interest," even though no reliance can actually be placed upon the insurance producer by the customer, and the relationship remains an arms-length relationship, not a bona fide fiduciary relationship under the law);
 - intentionally made (to enhance the marketing and promotion of insurance producer's products);
 - with the intention that consumers act upon it (through reliance, upon the insurance producer, to the detriment of the consumer);
 - leading to such actual reliance on the misrepresentation.

All the elements of intentional misrepresentation – *i.e.*, actual fraud, are present.

Moreover, when a definition is not present in the statute, "the plain and ordinary meaning is derived from the dictionary." *Cox v. Dir. Of Revenue*, 98 S.W.3d 548, 550 (Mo. banc 2003). "Fraud" is defined as "[a] knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." *Black's Law Dictionary* 731 (9th ed. 2009). "Deceit" is defined as "[t]he act of intentionally giving a false impression." *Id.* at 465. It is also defined as "[a] false statement of fact made by a person knowingly or recklessly with the intent that someone else will act upon it."

The Commission should not be a participant in, nor an endorser of, such fraudulent activity.

- 5.6. Proposed Regulation BI may well permit broker-dealers to engage in conduct that would otherwise violate state securities laws and/or other consumer protection laws which prohibit deceit and fraud. For example, Missouri securities legislation makes it unlawful for persons to engage in practices or a course of business that "operates or would operate as fraud or deceit."⁹⁸

⁹⁸ §409.5-502(a) (emphasis added); *cf.* 17 C.F.R. § 240.10b-5(c)

This language “quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible.”⁹⁹

⁹⁹ *Aaron v. Sec. & Exch. Comm'n*, 446 U.S. 680, 697, 100 S.Ct. 1945, 1955, 64 L.Ed.2d 611 (1980).