

**MEMO# 27086**

March 7, 2013

# **SEC Requests Data on Possible Fiduciary Duty for Broker-Dealers and IA-BD Harmonization**

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 13-13  
INVESTMENT ADVISER MEMBERS No. 20-13  
SEC RULES MEMBERS No. 29-13  
SMALL FUNDS MEMBERS No. 22-13 RE: SEC REQUESTS DATA ON POSSIBLE FIDUCIARY DUTY FOR BROKER-DEALERS AND IA-BD HARMONIZATION

The Securities and Exchange Commission has published a request for data and other information to assist it in considering whether to make new rules about the standards of conduct and regulatory obligations for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers (the "Consultation"). [\[1\]](#) Comments will be due to the SEC on July 5, 2013, which is 120 days after publication of the Consultation in the Federal Register.

## **Background**

Section 913 of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") required the SEC staff to make recommendations to enhance retail customer protections and decrease retail customers' confusion about the standard of conduct owed to them when their financial professional provides them personalized investment advice. The staff completed its study in January 2011, making two primary recommendations to the SEC. [\[2\]](#) First, the staff recommended that the SEC engage in rulemaking to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. Second, the staff recommended that the SEC consider harmonizing certain regulatory requirements applicable to broker-dealers and investment advisers where such harmonization appears likely to meaningfully enhance investor protection, taking into account the best elements of each regime.

The Consultation notes that the SEC received over 3,500 comment letters before and after the publication of the staff's Study, but few commenters provided data regarding the

benefits and costs of the current regulatory regime or the benefits and costs likely to be realized if the SEC were to follow the staff's recommendations. Accordingly, the Consultation requests data, particularly quantitative data and economic analysis, with respect to a wide range of questions relating to both staff recommendations.

In requesting this data, the SEC expressly recognizes that Section 913 of the Dodd-Frank Act does not mandate any rulemaking, and states that the SEC has not yet determined whether to commence a rulemaking. It is important to note that throughout the Consultation, the SEC reminds commenters that any particular assumptions made or questions posed do not suggest that the SEC has determined its policy views or the ultimate direction of its future action on these topics.

A summary of the Consultation follows. For the sake of context and completeness, we have summarized all of the SEC's principal requests for data. This is not meant to suggest that all of the questions in the Consultation directly relate to the sale of mutual funds and other registered investment companies. The Consultation is product-neutral—its questions relate to the provision of advice about any security to retail investors, and are not limited to advice about mutual funds and other registered investment companies. Accordingly, many of the requests for data may be outside the scope of any ICI response to the Consultation.

## **Request for Data Relating to the Current Market for Personalized Investment Advice**

The Consultation begins with a request for data and other information about the specific costs and benefits associated with the current regulatory regimes for broker-dealers and investment advisers, and in particular the economics and characteristics of the current regulatory regime, conflicts of interest, and the cost and effectiveness of disclosure.

There are fourteen separate requests for information in this part of the Consultation, many of which include secondary questions. Specifically, the Consultation requests data and other information on:

1. The characteristics of retail customers who invest through a broker-dealer as compared to those who invest on the basis of advice from an investment adviser, as well as retail customer perceptions of the cost/benefit tradeoffs of each regulatory regime;
2. The types and availability of services (including advice) broker-dealers or investment advisers offer to retail customers, as well as any observed recent changes in the types of services offered;
3. The extent to which different rules apply to similar activities of broker-dealers and investment advisers, and whether this difference is beneficial, harmful or neutral from the perspectives of retail customers and firms;
4. The types of securities broker-dealers or investment advisers offer or recommend to retail customers and, to the extent commenters believe that differences in the standards of conduct under the two regulatory regimes contribute to differences in the types of securities offered or recommended, data and other information as to why the types of securities offered or recommended may differ;
5. The cost to broker-dealers and investment advisers of providing personalized investment advice about securities to retail customers, as well as the cost to retail customers themselves of receiving personalized investment advice about securities;
6. The security selections of retail customers who are served by financial professionals

subject to the two existing regulatory regimes;

7. The extent to which broker-dealers and investment advisers engage in principal trading with retail customers, including data and other information regarding the types of securities bought and sold on a principal basis, the volume, and other relevant data points;
8. Retail customer returns (net and gross of fees, commissions, or other charges paid to a broker-dealer or investment adviser) generated under the two existing regulatory regimes;
9. The ability of retail customers to bring claims against their financial professional under each regulatory regime, with a particular focus on dollar costs to both firms and retail customers and the results when claims are brought;
10. The nature and magnitude of broker-dealer or investment adviser conflicts of interest and the benefits and costs of these conflicts to retail customers;
11. The costs of providing mandatory disclosure to retail customers about products and securities;
12. The effectiveness of disclosure to inform and protect retail customers from broker-dealer or investment adviser conflicts of interest;
13. The differences in state law contributing to differences in the provision of personalized investment advice to retail customers; and
14. The extent to which retail customers are confused about the regulatory status of the person from whom they receive financial services (i.e., whether the party is a broker-dealer or an investment adviser).

## **Uniform Fiduciary Duty for Broker-Dealers and Investment Advisers**

Nearly half of the Consultation explores the potential implications for the marketplace of alternative approaches to establishing a uniform fiduciary standard of conduct for broker-dealers and investment advisers.

In order to provide a common baseline for comments, the SEC sets forth a number of initial clarifications and assumptions, many of which directly address concerns expressed previously by ICI and other commenters. [\[3\]](#) The SEC expressly states that these clarifications and assumptions do not suggest their policy views or the ultimate direction of the SEC's actions on these issues.

For purposes of the Consultation, commenters are asked to assume that:

1. Any action would apply to all SEC-registered broker-dealers and SEC-registered investment advisers;
2. The uniform fiduciary standard of conduct would be designed to accommodate different business models and fee structures of firms, and would permit broker-dealers to continue to receive commissions (noting expressly that firms would not be required to charge an asset-based fee) and engage in principal trades (with appropriate disclosure of the material conflicts of interest, if any, presented by its compensation structure);
3. Section 206(3) and Section 206(4) of the Advisers Act and the rules thereunder would continue to apply to investment advisers, and would not apply to broker-dealers; [\[4\]](#)
4. The offering or recommending of only proprietary or a limited range of products would not, in and of itself, be considered a violation of the uniform fiduciary standard of conduct;

5. The uniform fiduciary standard of conduct would not generally require a broker-dealer or investment adviser to either (i) have a continuing duty of care or loyalty to a retail customer after providing him or her personalized investment advice about securities, or (ii) provide services to a retail customer beyond those agreed to between the retail customer and the broker-dealer or investment adviser; and
6. Existing applicable law and guidance governing broker-dealers, including SRO rules and guidance, would continue to apply to broker-dealers.

## **Discussion of a Possible Uniform Fiduciary Standard**

In Section 913 of the Dodd-Frank Act, which authorizes the SEC to impose a uniform fiduciary duty, Congress articulated a standard—“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.” Section 913 also expressly requires that any standard of conduct the SEC adopts “shall be no less stringent” than the standard applicable to investment advisers under Sections 206(1) and 206(2) of the Advisers Act.

In describing how the SEC might implement this standard of care, the Consultation discusses the two key components of a fiduciary duty—the duty of loyalty and the duty of care—and the application of prior guidance and precedent.

**The Duty of Loyalty.** The Consultation explains that the uniform fiduciary standard “would be designed to promote advice that is in the best interest of a retail customer by, at a minimum, requiring an investment adviser or a broker-dealer providing personalized investment advice to the customer to fulfill its duty of loyalty.” [\[5\]](#) This would be accomplished by “eliminating its material conflicts of interest, or providing full and fair disclosure to retail customers about those conflicts of interest.”

More specifically, the Consultation asks commenters to assume that any rule under consideration would:

1. Expressly impose certain disclosure requirements, including disclosure of all material conflicts of interest the broker-dealer or investment adviser has with respect to that retail customer and the delivery of a “general relationship guide” similar to Form ADV Part 2A, to be delivered at the time of entry into a retail customer relationship;
2. Treat conflicts of interest arising from principal trades the same as other conflicts of interest; and
3. Prohibit certain sales contests.

**The Duty of Care.** The Consultation asks commenters to assume that the SEC would implement the duty of care by imposing on a broker-dealer or investment adviser certain minimum professional obligations in four areas:

1. Suitability obligations: A duty to have a reasonable basis to believe that its securities and investment strategy recommendations are suitable for at least some customer(s) as well as for the specific retail customer to whom it makes the recommendation in light of the retail customer’s financial needs, objectives and circumstances;
2. Product-specific requirements: Specific disclosure, due diligence, or suitability requirements for certain securities products recommended; [\[6\]](#)
3. Duty of best execution: A duty on a broker-dealer and an investment adviser (where the investment adviser has the responsibility to select broker-dealers to execute client trades) to seek to execute customer trades on the most favorable terms reasonably

available under the circumstances; and

4. Fair and reasonable compensation: A requirement that broker-dealers and investment advisers receive compensation for services that is fair and reasonable, taking into consideration all relevant circumstances.

**Application of Prior Guidance and Precedent.** The staff's Study recommended that existing guidance under the Advisers Act regarding fiduciary duty should continue to apply to investment advisers and be extended to broker-dealers, as applicable, under a uniform fiduciary standard of conduct. In the Consultation, the SEC expressly acknowledges that existing guidance and precedent relating to investment advisers may not directly apply to broker-dealers, depending on the facts and circumstances. To aid commenters, however, it identifies two areas—the allocation of investment opportunities and the aggregation of orders—where commenters should assume that guidance and precedent would continue to apply to investment advisers and be extended to broker-dealers.

Given these assumptions, the Consultation then suggests six possible courses of action for the SEC:

1. Take a disclosure-only approach. The SEC could apply a uniform requirement for broker-dealers and investment advisers to provide disclosure about (a) key facets of the services they offer and the types of products or services they offer or have available to recommend and (b) material conflicts they may have with retail customers, without imposing a uniform fiduciary standard of conduct.
2. Adopt a uniform standard without extending existing guidance and precedent. The SEC could apply the uniform fiduciary standard of conduct on broker-dealers and investment advisers, but without extending to broker-dealers the existing guidance and precedent under the Advisers Act regarding fiduciary duty.
3. Adopt a "broker-dealer-only" standard. The SEC, without modifying the regulation of investment advisers, could apply part or all of the uniform fiduciary standard to broker-dealers.
4. Adopt a new rule only for investment advisers. The SEC, without modifying the regulation of broker-dealers, could specify certain minimum professional obligations under an investment adviser's duty of care (which are currently not specified by rule).
5. Consider models set by regulators in other countries. The Consultation notes certain aspects of regulations adopted by the United Kingdom's Financial Services Authority, the Treasury of Australia, and the European Securities and Markets Authority that the SEC could consider.
6. Retain the status quo. Finally, the Consultation notes that the SEC also could determine to take no further action at this time with respect to the standards of conduct applicable to broker-dealers and investment advisers.

Having set forth those assumptions and possible courses of action, the Consultation then poses a number of questions that relate to changes in the marketplace for personalized investment advice for retail customers that might occur as a result of implementing the uniform fiduciary duty. More specifically, the SEC seeks data on the types and availability of services (including advice) and securities that broker-dealers or investment advisers would offer or recommend to retail customers under the uniform fiduciary standard and under each of the alternative approaches discussed in the Consultation. The SEC notes that previous commenters have highlighted a number of services and activities that are most likely to be impacted by a uniform fiduciary standard:

- Recommending proprietary products and products of affiliates;

- Engaging in principal trades with respect to a recommended security (e.g., fixed income products);
- Recommending a limited range of products and/or services;
- Recommending a security underwritten by the firm or a broker-dealer affiliate, including initial public offerings;
- Allocating investment opportunities among retail customers (e.g., IPO allocation);
- Advising on a trading strategy involving concentrated positions;
- Receiving third-party compensation in connection with securities transactions or distributions (e.g., sales loads, ongoing asset-based fees, or revenue sharing); and
- Providing ongoing, episodic or one-time advice.

Other requests for information in this section involve the impact of the various possible approaches on the security selections of retail customers, the ability of retail customers to bring claims, investor confusion, implementation costs, and disclosure.

## **Discussion of Potential Areas for Further Regulatory Harmonization**

The final section of the Consultation seeks data and other information on potential areas, other than the standard of conduct, where the SEC might consider harmonizing the regulatory obligations of broker-dealers and investment advisers. These include:

1. Advertising and other communications. The SEC requests data on the general idea of harmonizing regulatory requirements for advertisements and other communications, and more specifically on developing similar substantive content rules and/or guidance, establishing consistent pre-use review requirements, and establishing consistent pre- and post-use filing requirements for broker-dealers and investment advisers.
2. The use of finders and solicitors. The SEC requests data on harmonizing the existing the existing regulatory requirements applicable to finders and solicitors. In particular, the SEC seeks data on the impact of establishing conflicts disclosure requirements associated with a solicitor's or finder's receipt of compensation.
3. Supervision. The SEC seeks feedback on harmonizing supervisory requirements of investment advisers and broker-dealers, including whether there are different costs and benefits to establishing a single set of universally applicable requirements versus scaling requirements based on the size (e.g., number of employees or a different metric) and nature of a broker-dealer or an investment adviser.
4. Licensing and registration of the firms. In addition to seeking data on the idea of harmonizing the licensing and registration of broker-dealers and investment advisers generally, the SEC seeks input on harmonizing the disclosure requirements in Form ADV and Form BD to the extent they address similar issues and imposing a substantive review of investment advisers prior to registration.
5. Continuing education requirements for associated persons. In addition to a general request for data, the SEC seeks data on the impact of requiring associated persons of investment advisers to be subject to federal qualification examinations and continuing education requirements.
6. Books and records requirements. The SEC specifically requests data on the impact of applying the "business as such" record retention requirement of Securities Exchange Act of 1934 Rule 17a-4 to investment advisers.

**endnotes**

[1] Duties of Brokers, Dealers, and Investment Advisers, SEC Release No. 34-69013 and IA-3558 (March 1, 2013), available at <http://www.sec.gov/rules/other/2013/34-69013.pdf>. For purposes of the Consultation, commenters are asked to assume that the term “personalized investment advice about securities” would include a “recommendation,” as interpreted under existing broker-dealer regulation, and would include any other actions or communications that would be considered investment advice about securities under the Advisers Act (such as comparisons of securities or asset allocation strategies), but would not include “impersonal investment advice” or general investor educational tools, and the term “retail customer” would mean “a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser and (2) uses such advice primarily for personal, family, or household purposes.”

[2] Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011) (the “Study”), available at [www.sec.gov/news/studies/2011/913studyfinal.pdf](http://www.sec.gov/news/studies/2011/913studyfinal.pdf).

[3] See Statement for the Record of Paul Schott Stevens, President and CEO of the Investment Company Institute, Hearing on “Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight,” Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, United States House of Representatives (September 13, 2011), available at [http://www.ici.org/pdf/11\\_house\\_fiduciary\\_stndrd\\_tmny.pdf](http://www.ici.org/pdf/11_house_fiduciary_stndrd_tmny.pdf). See also Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated August 30, 2010, available at <http://www.sec.gov/comments/4-606/4606-2570.pdf>.

[4] With respect to principal trades, the SEC asks commenters to assume that the rule would not incorporate the transaction-by-transaction disclosure and consent requirements of Section 206(3) of the Advisers Act for principal trading, and would not relieve an investment adviser from its obligations under Section 206(3).

[5] Dodd-Frank Section 913(g) addresses the duty of loyalty by providing: “[i]n accordance with such rules [that the Commission may promulgate with respect to the uniform fiduciary standard] . . . any material conflicts of interest shall be disclosed and may be consented to by the customer.”

[6] The Consultation lists a number of examples, including penny stocks, options, debt securities, municipal securities, interests in hedge funds, and structured products. It also includes in that list bond funds and mutual fund share classes.

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