

SEC Seeks Cost/Benefit Data Relating to Standards of Conduct for Broker-Dealers and Investment Advisers

March 06, 2013

March 6, 2013 -- On March 1, 2013, the SEC released a 72-page request (available [here](#)) for cost/benefit data and other information relating to different standards of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers (the "Request"). Interested persons may submit data, information, and other comments in response to the Request not later than 120 days after its publication in the Federal Register. On January 21, 2011, the SEC delivered to Congress a 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 "Study"). The Study discussed the different regulatory schemes that apply to broker-dealers and investment advisers. Among other things, the staff recommended that the SEC implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers that would require personalized investment advice to be "in the best interest of the [retail] customer." Now, the Request seeks additional information relevant to this recommendation and other matters covered in the Study. **Request for Information on Current Market** To be able to understand the impact of any proposed rulemaking, the Request seeks information about the costs and benefits of the currently applicable regulatory regimes. Among other specifics, the information sought regarding the current market for personalized investment advice includes:

- Differences in the rules that apply to similar activities of broker-dealers and investment advisers, and whether such differences are beneficial, harmful, or neutral;
- Characteristics of investors who invest on the basis of advice from broker-dealers, investment advisers, or both;
- Types and availability of advice and other services that broker-dealers or investment advisers offer to retail customers;

- How the respective regulatory regimes of broker-dealers and investment advisers affect their security selections;
- Investor returns generated under the respective regulatory regimes;
- Investor perceptions of the costs and benefits under each regime;
- Nature and magnitude of broker-dealer or investment adviser conflicts of interest and the costs and benefits thereof to retail customers;
- Broker-dealer or investment adviser costs of providing mandatory disclosure to retail customers about products and securities;
- Trading as principal with retail customers by broker-dealers and investment advisers, including the types and volume of securities purchased and sold; and
- How effectively and economically retail customers can bring claims against broker-dealers or investment advisers under their respective regulatory regimes.

Assumptions Upon Which Comments Should Be Based Because "[a] uniform fiduciary standard of conduct can be understood quite differently by various parties," the Request includes "assumptions" that commenters should take into account and that would facilitate the SEC's ability to compare and analyze responses to its questions. The assumptions include:

- "Personalized investment advice about securities" generally would mean a "recommendation" or other action or communication that would be considered investment advice about securities (such as an asset allocation strategy);
- "Retail customer" would mean a natural person, or the legal representative thereof, who uses such advice primarily for personal, family, or household purposes;
- The standard of conduct would apply to all SEC-registered broker-dealers and SEC-registered investment advisers;
- That standard, however, would be designed to accommodate different business models and fee structures of firms, and would permit broker-dealers to continue to receive commissions and to engage in principal transactions with retail customers without any requirement for transaction-by-transaction disclosure and consent;
- The standard would not generally require a broker-dealer or investment adviser (1) to have a continuing duty after providing personalized securities advice, absent contractual or other understandings that create such a continuing duty or (2) otherwise to provide services beyond those agreed to with the customer;
- The offering or recommending of only proprietary or a limited range of products would not, in itself, violate the standard;

- The general anti-fraud provision in Section 206(3) of the Investment Advisers Act, and the rules thereunder, would continue to apply to investment advisers, but would not apply to broker-dealers; and
- The standard of conduct generally would not replace, but would be in addition to all existing legal requirements and standards applicable to broker-dealers and investment advisers.

The Request addresses the two components of the uniform fiduciary standard - duty of loyalty and duty of care - and requests that commenters make additional assumptions specific to each component. As to the *duty of loyalty*, for example, the assumptions include that, in connection with providing personalized securities advice to retail customers, the broker-dealer or investment adviser would be:

- required either to eliminate all material conflicts of interest or to provide full and fair disclosure to customers about those conflicts. This would include, for example, disclosure about principal transactions with customers;
- prohibited from receiving or paying non-cash compensation (e.g., trips and prizes);
- required to disclose to customers how it will allocate investment opportunities among its customers and between customers and the firm's own account;
- required to disclose whether and under what conditions it may aggregate the securities orders of different customers; and
- prohibited from favoring one customer over another in connection with any such aggregation.

As to the *duty of care*, the assumptions include the imposition of certain minimum professional obligations that would apply both to broker-dealers and investment advisers and that would be designed to promote advice that is in the best interest of customers. For example, commenters are asked to assume that, in connection with providing any personalized securities advice to retail customers, broker-dealers and investment advisers would be obligated to:

- have a reasonable basis to believe that the advice is suitable in light of the customer's financial needs, objectives, and circumstances;
- observe heightened disclosure, due diligence, or suitability requirements where the advice concerns certain types of securities (such as penny stocks, options, debt securities, bond funds, municipal securities, mutual fund share classes, interests in hedge funds, and structured products); and
- receive compensation that is fair and reasonable.

Alternative Approaches to the Uniform Fiduciary Standard of Conduct The Request makes clear that the SEC has not formed any conclusion about the extent to which any uniform fiduciary standard of conduct that it implements would or should conform to any or all of the above

assumptions. Any action that the SEC takes may differ greatly from those assumptions. Indeed, the Request also specifically seeks data and information on each of five other approaches that the SEC might implement instead:

- Impose a uniform requirement for broker-dealers and investment advisers to provide disclosure about key facets of the products and services they offer and material conflicts they may have, *without imposing a uniform fiduciary standard of conduct*;
- Impose the uniform fiduciary standard of conduct discussed in the Request on broker-dealers and investment advisers, *but without extending to broker-dealers certain requirements such as those mentioned above with respect to allocating investment opportunities and aggregating securities orders*;
- Impose the uniform fiduciary standard of conduct discussed in the Request, or parts thereof, only on broker-dealers (*i.e., without modifying the regulation of investment advisers*);
- Specify certain minimum professional obligations under an investment adviser's duty of care without modifying the regulation of broker-dealers; or
- Consider whether models set by regulators in other countries should be adopted.

The Request asks commenters to consider how imposition of the uniform fiduciary standard, as well as each of the above alternatives, might affect the current market for personalized investment advice, with a focus on the types of information on the current market that the SEC is requesting, as itemized above. **Potential Areas for Further Regulatory Harmonization** The Request also seeks comments on whether it may be appropriate to "harmonize" the regulatory treatment of broker-dealers and investment advisers as to:

- Advertising and other communications;
- Use of finders and solicitors;
- Supervision;
- Licensing and registration of firms;
- Continuing education requirements for persons associated with broker-dealers and investment advisers; and
- Books and records.

The Request also seeks comments on what any such harmonization should entail, and the costs and benefits associated with such harmonization, including the extent to which such harmonization would increase or reduce retail customer confusion about the regulatory obligations of broker-dealers and investment advisers.

Authored By



Ann Young Black



Ann Began Furman



Thomas C. Lauerman

Related Practices

[Business Transactions](#)

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.