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# Analysis of the SEC Staff's Study: SEC Responds to Congress on a Uniform Fiduciary Standard for Investment Advisers & Broker-Dealers

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Late in the evening on Friday, January 21, the Securities and Exchange Commission (SEC) Staff released its long-anticipated *Study on Investment Advisers and Broker-Dealers* (the Study), which was required by § 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).[1] The Study generally frames the issues for the remapping of the regulation of investment advisers and broker-dealers, and could have a dramatic affect on the business models of and services offered by investment advisers and broker-dealers. The heart of the Study is the SEC Staff's expected recommendation to establish, through rulemaking, a uniform fiduciary standard for investment advisers and broker-dealers that is consistent with the standard that currently applies to investment advisers under the Investment Advisers Act of 1940 (the Advisers Act). Specifically, the Staff recommends the adoption of the following uniform fiduciary standard based on the statutory language in the Dodd-Frank Act:

> **[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.[2]**

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As discussed in the Study, the Staff recognizes that retail investors may be generally confused about the distinctions between investment advisers and broker-dealers and often may view them as interchangeable investment professionals. Many on the SEC Staff, therefore, believe that a uniform fiduciary standard not only will help to protect retail investors, but "match legal obligations with the expectations and needs of investors, who are often confused about the roles of investment advisers and broker-dealers."[3]

## Summary of Staff Recommendations

In addition to recommending the establishment of a uniform fiduciary standard, the SEC Staff recommends that the SEC undertake a number of actions, certain of which are outlined below, to facilitate the implementation of the recommended uniform fiduciary standard and harmonize the broker-dealer and investment adviser regulatory regimes.

### Duties of Loyalty and Care

The Staff recommends that the SEC engage in rulemaking or issue interpretive guidance clarifying the duty of loyalty and duty of care components of the uniform fiduciary standard. The Staff also recommends that the SEC consider specifying uniform standards for the duty of care owed to retail investors, through rulemaking and/or interpretive guidance.

### Disclosure and Advertising

The Staff recommends that the SEC develop consistent and substantive customer communication rules to facilitate the provision of uniform, simple, and clear disclosures to retail investors about the terms of their relationships with broker-dealers and investment advisers, and of conflicts of interest. At a minimum, the Staff recommends that the SEC articulate consistent rules on the prereview and approval of customer communications. To further the improvement of disclosure available to investors, the Staff also recommends that the SEC consider whether the Form ADV and Form BD disclosure requirements should be harmonized.

### Principal Trading

The Staff recommends that the SEC address through interpretive guidance or rulemaking how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading in light of the fact that they are not required to comply with principal trade provisions similar to those imposed on investment advisers and do not have a continuing duty of care or loyalty to a retail customer after providing investment advice.

### Personalized Investment Advice

The Staff recommends that the SEC engage in rulemaking and/or interpretive guidance to explain what it means to provide "personalized investment advice about securities." Here, the SEC Staff recommends that, at a minimum, the definition should include "recommendations" as understood under the broker-dealer regulatory scheme and exclude "impersonal investment advice" as understood under the investment adviser regulatory scheme.

### Solicitation Arrangements

The Staff recommends that the SEC consider whether to provide additional guidance or harmonize regulatory requirements to address the status of finders and solicitors and their respective disclosure requirements concerning the conflicts associated with the solicitor's and finder's receipt of compensation.

### Supervisory Requirements

The Staff recommends that the SEC review supervisory requirements for investment advisers and broker-dealers to determine whether harmonization would facilitate the examination and oversight of these entities, and to consider whether to provide additional guidance or engage in rulemaking.

### Registration, Licensing, and Continuing Education

The Staff recommends that the SEC consider requiring investment adviser representatives to be subject to federal licensing and continuing edu-

cation requirements. The Staff also recommends that the SEC consider whether to harmonize broker-dealer and investment adviser registration processes, including notably, subjecting investment advisers to a substantive review prior to registration.

### Books and Records

The Staff recommends that the SEC consider whether to modify the Advisers Act books and records requirements, specifically by requiring investment advisers to retain all communications and documentation relating to their business as an investment adviser similar to the requirements currently applicable to broker-dealers.

## Thoughts on the Study and SEC Staff Recommendations

The Study is well-considered and comprehensive, and is interesting for what it includes and for what it does not. For the most part, the Study seems to include commentary and proposals on which the Divisions of Trading & Markets and Investment Management could reach consensus or at least compromise. The result is that some points have been tempered or qualified, with the finer or possibly more contentious aspects left for another day's debate. In many instances, the comparison of the existing investment adviser and broker-dealer regulation sometimes reads like one side's critique of the other's regulatory scheme, albeit one that has been toned down to mask internal divisions. For example, the contrast between the specificity of the broker-dealer regulatory scheme and the broad and principle-based nature of the Advisers Act regulation is an obvious area of tension reflected in the Study.

The Study notes that the Staff did consider alternative solutions to the adoption of a uniform fiduciary standard. In fact, the Study discusses—but wisely dismisses—the idea of repealing the broker-dealer exclusion entirely. The Staff ultimately determined, however, that the recommended uniform fiduciary standard provides the most appropriate solution.

It is not at all clear how the SEC might address or implement certain of the Staff's recommendations. The divisions within the SEC (as reflected by the two dissents), and within the Staff itself, on many aspects of the proposals (including, in particular, those the Study only briefly discusses), the fact that, in the near future, at least some of the issues addressed in the Study may be picked up in hearings before Congress, the extraordinary demands facing the SEC and its Staff as they attempt to carry out other of their Dodd-Frank Act obligations, and the contentious SEC budget negotiations currently being played out in the House of Representatives all contribute to the unpredictability of the SEC's ultimate response to the Study's recommendations.

### Justification of Uniform Fiduciary Standard

In support of the need for a uniform fiduciary standard, the Study cites retail customers' lack of understanding and confusion of the different roles played by investment advisers and broker-dealers and, in particular, the relevant standard of care each owes to a retail customer when providing personalized investment advice about securities. The Staff notes that the lack of understanding is compounded by retail customers' need to rely on their financial professionals in today's sophisticated marketplace and the gravity of the decisions about which they are seeking advice. The Study's discussion of the justification for a uniform fiduciary standard, however, proved lacking to Commissioners Kathleen L. Casey and Troy A. Paredes. In a separate statement, the Commissioners state that "the Study's shortcoming is that it fails to adequately justify its recommendation that the Commission embark on fundamentally changing the regulatory regime for broker-dealers and investment advisers providing personalized investment advice to retail investors."[4] In subsequent remarks, Commissioner Elisse B. Walter did not criticize the Study's lack of justification for a uniform fiduciary standard, but its inadequate explanation of what the proposed uniform fiduciary

standard would require of investment advisers and broker-dealers.[5]

Interestingly, while the Study cites numerous statistics on the metrics surrounding the investment adviser and broker-dealer businesses, it largely fails to correlate the two or make the unmistakable point that, by far, the largest investment advisers in terms of number of clients and financial professionals are broker-dealers, and that broker-dealers represent, by far, the largest segment of investment advisers serving retail customers.

## Personalized Investment Advice

The Study appropriately recognizes the importance of defining the phrase "personalized investment advice" and indicates that the Staff believes it is possible to craft a definition that accommodates the scope and history of both the investment adviser and broker-dealer regulatory regimes. The Study notes that the "Staff believes that such a definition at a minimum should encompass the making of a 'recommendation,' as developed under broker-dealer regulation, and should not include 'impersonal investment advice' as developed under the Advisers Act."[6] In addition, in its discussion of the definition of "retail customers," the Staff recommends that the SEC, among other clarifications, "specify that personalized investment advice provided to retail customers includes both advice to a specific retail customer on a one-on-one basis and… to a group of retail customers under circumstances in which members of the group reasonably would believe that the advice is intended for them."[7]

The concept of "personalized investment advice" espoused by the Staff seems to pick up customer-specific recommendations for broker-dealer purposes, but there may be unforeseen consequences of the Staff's definitional approach of including all recommendations (including non-customer-specific recommendations that carry only reasonable-basis suitability obligations) and then excluding recommendations that involve impersonal investment advice as understood under the Advisers Act. Similarly, the somewhat unusual articulation of group-wide personalized advice is troubling and could subsume "participant education" that may currently be regarded as not involving investment advice under the Advisers Act and Employee Retirement Income Security Act (ERISA). This articulation would, at the very least, require refinement and interpretation to make sure that the SEC will recognize the sufficiency of caveats and disclosures so that an investment adviser or broker-dealer may reasonably negate any intimation that it has provided personalized investment advice to persons participating in a group meeting.

## Retail Customers

"Retail customer" is defined in new Advisers Act § 211(g)(2) as "a natural person, or the legal representative of such natural person, who (A) receives personalized investment advice about securities from a broker-dealer or investment adviser; and (B) uses such advice primarily for personal, family, or household purposes."[8] The Study acknowledges that the definition does not differentiate among investors on the basis of their wealth or investment experience.[9] In the Study, the Staff also notes that it is concerned about communications with prospective customers to the extent they are not considered "retail customers," but then notes that the SEC's "anti-fraud authority under both Advisers Act Sections 206(1) and (2) and Securities Exchange Act of 1934 (the Exchange Act) Section 10(b) extends to fraudulent recommendations and other communications made to both existing and prospective clients and customers," thereby providing ample protection to prospective retail customers.[10] The Staff also suggests that the SEC "could consider whether the uniform fiduciary standard should also be extended to persons other than retail customers that may also benefit from… the standard."[11]

The Study does not address comments from various firms that the concept of "retail customer" ought to be reconciled with institutional suitability principles and the designation of wealthy individuals (*i.e.*, with assets of $50 million or more) as institutional clients under the Financial

Industry Regulatory Authority (FINRA) rules approved by the SEC. Rather, the SEC Staff specifically highlights that the definition does not distinguish among investors based on wealth. In addition, the recommended extension of the proposed uniform fiduciary standard to prospective customers is problematic since firms may not have gathered complete information about certain customers, and there should not be an expectation that a firm is providing personalized investment advice to which the proposed standard attaches. Notably, however, the SEC Staff seems to counterbalance the suggestion that retail customers might include prospective customers by pointing out its antifraud authority under § 10(b) of the Exchange Act.

## Acknowledgement of Broker-Dealer Defenses

The SEC Staff acknowledges with deference the provisions of § 913 of the Dodd-Frank Act, making it clear that the receipt of commission-based compensation or other standard compensation does not *per se* violate the uniform fiduciary standard and that the standard does not require broker-dealers to have a continuing duty of care or loyalty after providing personalized investment advice.[12] The Study also acknowledges (without substantive discussion) that § 913 permits broker-dealers to offer only proprietary products without violating the uniform standard, but proposes in passing that such activity "may be subject to disclosure *and consent* requirements."[13] The Study, however, does not address the interpretive questions that may arise, including the meaning of "standard compensation," which is possibly ambiguous. For example, should standard compensation include all of the types of compensation the Staff notes that broker-dealers may receive (*e.g.*, asset-based fees, commissions, markups and markdowns, and revenue sharing)?[14]

## Need for Interpretive Guidance

While the Staff states it believes that the "existing guidance and precedent under the Advisers Act regarding fiduciary duty… will continue to apply to investment advisers and be extended to broker-dealers, as applicable, under the uniform fiduciary standard,"[15] it acknowledges that there still will be a need for additional rulemaking and interpretive guidance to aid in the transition to any new uniform fiduciary standard. To that end, the Staff recommends that the SEC's rulemaking and guidance "should particularly focus on assisting broker-dealers with complying with the minimum requirements of the uniform fiduciary standard and what it means to generally operate under the uniform fiduciary standard."[16]

The Staff's focus on assisting broker-dealers with the application of the uniform fiduciary standard is valid, but belies the fact that most of the guidance and precedent on fiduciary duty under the Advisers Act is principle-based and often unnuanced, essentially treating the characterization of one as a fiduciary as a conclusion unto itself. This approach is largely based on archaic concepts of fiduciary law—derived from common law—that, among other things, do not factor in the various roles played by contemporary fiduciaries and the intricate regulatory framework that has evolved to regulate their activities. By contrast, the approach to regulating broker-dealers is more granular and fact-based. (As the Study notes, "[g]enerally, under the antifraud provisions, a broker-dealer's duty to disclose material information to its customer is based upon the scope of the relationship with the customer, which is fact intensive."[17]) Thus, any SEC guidance in this area needs to focus not only on easing the transition of broker-dealers, but also on improving the clarity of both the existing guidance and precedent under the Advisers Act and its application to both investment advisers and broker-dealers alike. In addition, the SEC and its Staff should consider providing interpretive guidance on a purely prospective basis so as to avoid any question or claim that an investment adviser or broker-dealer has not lived up to its prior obligations by virtue of future SEC and Staff pronouncements.

## "Uniform Baseline Standards" for Duty of Care

In an effort to address the discrepancy between the level of specificity of the duty of care obligations under the Advisers Act versus broker-dealers' duty of care under FINRA's professional standards of conduct, the Staff recommends that the SEC "specify the minimum professional obligations of investment advisers and broker-dealers under the duty of care" (*i.e.*, "rules or guidance on the minimum requirements that are fundamental to a duty of care under the uniform fiduciary standard").[18] The Staff then discusses possible professional standards that could be imposed, including standards concerning the appropriate level of review and analysis when making recommendations to retail customers. Due to the inherent difficulty in establishing standards of conduct with sufficient flexibility to accommodate varying business models, products and services, and circumstances, the Staff "recommends that any rulemaking or guidance explicitly provide that it establishes only *minimum* expectations for the appropriate standard of conduct and does not establish a safe harbor or otherwise prevent the [SEC] from applying a higher standard of conduct based on specific facts and circumstances."[19]

***In addition, the SEC and its Staff should consider providing interpretive guidance on a purely prospective basis so as to avoid any question or claim that an investment adviser or broker-dealer has not lived up to its prior obligations by virtue of future SEC and Staff pronouncements.***

The call for uniform baseline standards of care is both interesting and problematic. It is interesting in the sense that it might seek to address a concern that Advisers Act guidance is insufficiently concrete and specific (certainly by comparison to broker-dealer regulation and guidance). It is problematic in that baseline standards of care are hard to establish in concrete and specific terms except perhaps by way of process (*e.g.*, know-your-customer/information gathering and due diligence to support suitability obligations). This is a proposal that, if acted on, might create far greater burdens for investment advisers.

## Relation to Other Laws

In its discussion of the application of the recommended uniform fiduciary standard, the Staff states that the recommended uniform fiduciary standard "would not have any direct bearing on other persons who may be characterized as fiduciaries in other areas of the law, including ERISA fiduciaries or financial institutions such as banks and trust companies."[20] The Staff's statement that the uniform fiduciary standard would not affect whether someone is a fiduciary under other bodies of law, including ERISA, dodges the important issue of whether the uniform fiduciary standard might be bootstrapped in other circumstances to create greater liability on the part of investment advisers and broker-dealers under other laws. Moreover, the Staff notes without comment the Department of Labor's (DOL's) recent proposal to amend its definition of "investment advice"[21]—and therefore the definition of who is a fiduciary under ERISA—in a way that is widely recognized as problematic for broker-dealers and investment advisers alike. This is an important area in which the SEC will hopefully be engaged, through both SEC comment and participation in public hearings, similar to its involvement when the DOL first adopted the definition of "investment advice" in 1975.

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Importantly, the Staff also declared that it "contemplates that the uniform fiduciary standard would be an 'overlay' on top of the existing investment adviser and broker-dealer regimes and would supplement them, and not supplant them."[22] Taken literally, this could mean that broker-dealers that are dual registrants would possibly have to struggle to manage their businesses and the conduct of their personnel under multiple different standards—possibly as many as eight to be exact—depending on the firm's role, the type of advice provided, and the nature of the client. (*See chart.*)

## Relationship Disclosure Document/ Broker-Dealer "Form BD Part 2"

In the Study, the Staff recommends that the SEC facilitate the use of more clear and concise disclosures to retail customers that explain the client's relationship with the investment adviser or broker-dealer and any material conflicts of interest that may be present in such relationship. Specifically, the Staff recommends that the SEC "consider the disclosures that should be provided (a) in a general relationship guide akin to the new Form ADV Part 2A that advisers deliver at the time of entry into the client relationship, and (b) in more specific disclosures at the time of providing investment advice (*e.g.*, about certain transactions that the SEC believes raise particular customer protection concerns)."[23] It is unclear whether the discussion of broker-dealer disclosure about the terms of their relationships with retail investors should be read as an intention to supplant the recent efforts by FINRA to create a customer relationship document.[24]

| *Potential Standards* | |
|---|---|
| **Investment Advisers** | **Broker-Dealers** |
| **standard for advisers (outside the uniform fiduciary standard (UFS))** | **the standard for broker-dealers (outside the UFS)** |
| **Adviser - UFS** | **Broker-Dealer - UFS** |
| **Adviser - ERISA** | **Broker-Dealer - ERISA** |
| **Adviser – UFS & ERISA** | **Broker-Dealer – UFS & ERISA** |

***Taken literally, this could mean that broker-dealers that are dual registrants would possibly have to struggle to manage their businesses and the conduct of their personnel under multiple different standards—possibly as many as eight to be exact—depending on the firm's role, the type of advice provided, and the nature of the client.***

Despite the fact that the Staff's recommendations would likely result in the production and delivery of additional disclosure, the Staff recognizes that "too much information can overwhelm retail customers, and may lead them to miss important information or ignore disclosure altogether."[25] Therefore, the Staff recommends that the SEC "consider the utility and feasibility of a summary disclosure document containing key information on a firm's services, fees, and conflicts and the scope of its services (*e.g.*, whether its advice and related duties are limited in time or are ongoing)."[26] It is conceivable that any effort to reconcile these competing efforts could feed possible liability for investment advisers and broker-dealers that either have sought to provide exhaustive disclosure of conflicts and how they are addressed or attempted to provide concise summary documentation. The SEC and the Staff need only to recall the liability concerns that were raised with the use of a summary prospectus for registered investment companies to anticipate the issues and concerns that investment advisers and broker-dealers may legitimately raise in response to a requirement to use a summary disclosure document to relate key information.

In a rather limited discussion, the Staff also expresses its concern that investment advisers and broker-dealers not be allowed to "disclose away" conflicts of interest under the uniform fiduciary standard. While the Staff acknowledges that the "basic protections regarding conflicts of interest currently available under the Advisers Act would be preserved and would not be watered down,"[27] it nonetheless recommends that the SEC consider rulemaking "to prohibit certain conflicts, or where it might be appropriate to impose specific disclosure and consent requirements (*e.g.*, in writing and in a specific format, and at a specific time) in order to better assure that retail customers were fully informed and can understand any material conflicts."[28] The Staff's reference to possibly prohibiting certain conflicts is notable and could potentially affect advisers' current approach to conflicts of interest disclosures.

## Comparable Enforcement and Non-Scienter Based Enforcement

Of possible concern is the Staff's intimation that the SEC may seek to enforce the new uniform fiduciary standard under a theory that it does not require scienter or intent to prove a violation of the standard. This position is based on case law establishing that scienter is not required for actions brought under § 206(2) of the Advisers Act. The Study notes that Exchange Act § 15(m) provides that the SEC's enforcement authority for violations of the "standard of conduct applicable to broker-dealers providing personalized investment advice about securities to retail customers shall include enforcement authority of the SEC with respect to violations of the standard of conduct applicable to an investment adviser under the Advisers Act, including the authority to impose sanctions for such violations."[29] Exchange Act § 15(m) also provides that the SEC shall seek to prosecute and sanction broker-dealers for such violations "to the same extent as it prosecutes and sanctions violators" under the Advisers Act.[30] The Study notes that § 913(h) of the Dodd-Frank Act provides for equivalent authority under § 211(i) of the Advisers Act. The Staff explains that, as a result, it contemplates "that any rules implementing the uniform fiduciary standard would provide, at a minimum, for violations of the standard not involving scienter to the same extent as the [SEC] currently enforces antifraud violations involving a breach of fiduciary duty under Advisers Act § 206(2)."[31] In a footnote, the Staff notes that "[s]uch rules could enable the [SEC] to en-

force the uniform fiduciary duty of broker-dealers and investment advisers providing personalized investment advice about securities in contexts not involving fraud."[32]

## Principal Trading

The Study rightly observes that the Dodd-Frank Act does not contemplate application of the Advisers Act's principal trading restrictions to broker-dealers subject to the uniform fiduciary standard.[33] However, the Staff makes assorted statements that suggest the Staff's intent to require that a broker-dealer augment its existing disclosure requirements and "at a minimum… disclose its conflicts of interest related to principal transactions"; such disclosure should "provide sufficiently specific facts so that investors are able to understand the conflicts of interest."[34]The Staff then states that a broker-dealer "would not *necessarily* be required to follow the specific notice and consent procedures of the Advisers Act § 206(3)."[35] With respect to investment advisers, who are subject to a consent requirement, the Staff makes clear that it "believes that requests for consent embedded in voluminous advisory agreements or other account opening agreements would impede the provision of such consent."[36]

***The Staff's reference to possibly prohibiting certain conflicts is notable and could potentially affect advisers' current approach to conflicts of interest disclosures.***

While the Study raises the possibility of changes in how the principal trading requirements of the Advisers Act apply to investment advisers (presumably including broker-dealers acting as investment advisers), it makes no concrete proposals and even cites examples of enforcement cases against dual registrants for engaging in riskless principal transactions when there is substantial justification for excluding them from § 206(3)'s restrictions subject to appropriate safeguards.

## Possible Focus on Internalization

In conjunction with addressing how broker-dealers would satisfy the uniform fiduciary standard and considering "whether any changes should be made to the principal trading requirements that apply to investment advisers,"[37] the Staff suggests that the SEC "should also consider addressing potential conflicts of internalization and other practices that may be analogous to 'agency cross' trades."[38]

## Harmonizing Books and Records Requirements

The Study's recommendation for harmonizing the recordkeeping requirements of investment advisers with those of broker-dealers has long been expected.

In the Study, the Staff notes that while certain differences in existing recordkeeping requirements of investment advisers and broker-dealers are attributable to differences in the business activities of the two and thus are justified, others are not. The Staff emphasizes that the recordkeeping requirements under the Advisers Act are not as all-encompassing as those prescribed for broker-dealers and thus "limit the effectiveness of internal supervision and compliance structures and the ability of regulators to access information and verify the entity's compliance with applicable requirements."[39] If carried out, this recommendation will affect all investment advisers, but might be especially burdensome for smaller ones.

## Harmonizing Registration, Licensing and Continuing Education Requirements

Addressing the possibility of using a single form to register both investment advisers and broker-dealers, the Staff explains that such a requirement would likely be more burdensome than beneficial,[40] and therefore recommends only that the SEC consider making overlapping portions of Form ADV and Form BD as uniform as possible. The Staff, however, does imply that investment advisers and their retail customers might benefit from a review process prior to an investment ad-

viser's registration, which is similar to the FINRA application review process to which broker-dealers are subject. Although the Study focuses on conducting a preregistration review like that conducted by FINRA for its broker-dealer members, it does not propose similar reviews of material changes in investment advisory businesses as the Study notes FINRA undertakes under FINRA Rule 1017.

The Study next focuses on the lack of a federal or Self-Regulatory Organization (SRO) licensing requirements for investment adviser personnel, and acknowledges that the "lack of a continuing education requirement and uniform federal licensing requirement for investment adviser representatives may be a gap, but establishing such requirements for investment adviser representatives may raise certain challenges for the [SEC], given the current lack of infrastructure and resources to administer an education and testing program."[41] Notably, the Staff leaves open the possibility that a private organization could develop and oversee such a program. Generally, harmonizing investment adviser registration, supervised-person licensing, and continuing education to the broker-dealer paradigm would be a burdensome change for large and small investment advisory firms alike.

## Harmonizing Regulation of Advertising and Other Communications

In the Study, the Staff briefly discusses the differences in the regulation of advertising between broker-dealers and investment advisers and notes that some commenters believe that the differences produce gaps in regulation. The Staff explains that while "the general prohibitions are broadly similar, the specific content restrictions differ. For example, investment advisers are prohibited in advertisements from using testimonials and restricted in using past specific recommendations."[42] The Staff then rationalizes these particular differences, specifically noting that while broker-dealers are not subject to restrictions on testimonials, they are subject to restrictions on testimonials containing past specific recommendations. Unfortunately, the Staff passes up the opportunity to recommend that Rule 206(4)-1 of the Advisers Act be revised or made more transparent to reflect current no-action positions. The Staff also acknowledges that the guidance on whether performance presentations are misleading is far more developed under the Advisers Act largely due to the fact that broker-dealers advertise performance less often, but the Staff does not address whether arguably overly strict FINRA standards on use of performance information (including related performance and projections) should be better reconciled with SEC guidance.

The Study and the Staff seem most focused on requiring that investment advisers designate supervised persons to review and approve advertisements, as is required for broker-dealers.[43] Specifically, the Staff proposes that, "at a minimum, it could be beneficial for investment advisers to designate employees (such as members of the firm's compliance department) to review and approve communications before they are distributed to the public."[44] The Study also notes FINRA filing requirements for broker-dealers, but does not propose to require that for investment advisers.

## Harmonizing Regulation of Solicitation Arrangements

In its discussion of the treatment of solicitation arrangements, the Study contrasts the broker-dealer regulatory regime, which generally requires persons to register as broker-dealers if they receive "transaction-based compensation in exchange for effecting transactions in securities (including soliciting investors)," with the Advisers Act regulatory regime under which solicitors are not required to register as investment advisers, but are instead required to disclose to clients the material conflicts of interest that are present in a solicitation arrangement and act under the supervision of an investment adviser.[45] As recommended by the Staff, harmonization of solicitation arrangements could be very useful, but would have to factor in, among other things, the divergent approach to registration, cross-over issues with pay-to-play restrictions, international finders, applicability of solicitation rules to associated and supervised persons, and the bar under Rule 206(4)-3 of using disqualified solicitors (for

**At-a-Glance Impact of Recommendations**

| | Investment Advisers | Broker-Dealers |
|---|---|---|
| **Common Impacts** | • UFS would apply to both investment advisers and broker-dealers with some qualifications. | |
| | • Investment advisers and broker-dealers may be required to create and distribute a summary disclosure document highlighting fees, services, and conflict-of-interest information. | |
| | • Investment advisers and broker-dealers may become subject to a uniform baseline standard for duty of care. | |
| | • Investment advisers and broker-dealers may be affected by interpretive guidance under the UFS relating to the disclosure or prohibition of certain conflicts. | |
| **Disparate Impacts** | • Investment advisers may be subject to a substantive pre-registration review. | • Broker-dealers may be required to provide customers with disclosure and obtain consent related to the use of proprietary products. |
| | • Federal or SRO licensing requirements may be imposed for investment adviser supervised persons. | • Broker-dealers may be required to revise the presentation of their disclosure and obtain consent relating to principal trades. |
| | • Investment adviser supervised persons may become subject to continuing education requirements. | • Broker-dealers may be required to create and distribute Form ADV, Part 2–type disclosure to customers. |
| | • Investment advisers may be required to designate a supervised person to review and pre-approve advertising. | • UFS's definition of "retail customer" would likely override institutional suitability doctrine for natural persons who qualify as institutional clients. |
| | • Investment advisers may be required to expand the recordkeeping practices to include e-mail communications and information relating to their business. | • Broker-dealers may be required to enhance supervisory controls for personal securities trading activity. |

which the SEC Staff has provided relief subject to additional disclosure requirements).

## Harmonizing Supervisory Frameworks

The Study notes that, while both investment advisers and broker-dealers have an obligation "to supervise persons that act on their behalf, broker-dealers generally are subject to more specific supervisory requirements."[46] The Study also highlights that "the personal securities trading provisions of the Advisers Act code of ethics rule (Advisers Act Rule 204A-1) are more extensive in certain respects than the requirement that broker-dealers supervise private securities transactions."[47] Ultimately, however, the Staff notes that

it received little in the way of comments concerning how best to harmonize the two regulatory regimes and thus recommends only that the SEC consider reviewing supervisory requirements. Despite just recommending review, implicit in the Staff's observations are possible future proposals that supervisory requirements for advisers be made more explicit and specific, and that broker-dealer supervision of personal securities trading be made more extensive.

## Conclusion

In conclusion, the Staff's efforts to address the potential harmonization of the investment adviser and broker-dealer regulatory schemes in the Study are commendable, but a great deal more is needed if the SEC is to truly harmonize the regulation of investment advisers and broker-dealers without adding further ill-fitting patches to the patchwork quilt that is the federal securities regulatory scheme; while at the same time, respecting the legitimate differences in the business models of investment advisers and broker-dealers.

**NOTES**

1. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), § 913(b): "The Commission shall conduct a study to evaluate—(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and (2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute."
2. *Study on Investment Advisers and Broker-Dealers* (the Study) at vi. The Staff of the Securities and Exchange Commission (SEC) released the Study on January 21, 2011. It is available on the SEC Web site at http://www.sec.gov/news/studies/2011/913studyfinal.pdf.
3. Commissioner Elisse B. Walter, "A Tale of Two Studies: Investment Management Institute Keynote Remarks," (February 10, 2011).
4. Commissioners Kathleen L. Casey and Troy A. Paredes, "Statement by SEC Commissioners: Statement Regarding Study on Investment Advisers and Broker-Dealers" (January 21, 2011).
5. Walter, "A Tale of Two Studies."
6. The Study at 127.
7. The Study.
8. The Study at 127 n.582.
9. The Study.
10. The Study at 128 n.583.
11. The Study at 127.
12. The Study at 113.
13. The Study. (*emphasis added*).
14. Interestingly, while the Staff briefly references the broker-dealer exclusion elsewhere in the Study as an alternative solution it had considered, the Staff does not take advantage of this opportunity to recommend that Congress revisit the broker-dealer exclusion to address interpretive issues concerning the meaning of "special compensation" under § 202(a)(11) in light of the D.C. Circuit Court's *FPA* decision, including so as to exclude "hard dollar" research arrangements from the ambit of the Advisers Act. [*See Financial Planning Ass'n v. S.E.C.*, 482 F.3d 481, Fed. Sec. L. Rep. (CCH) P 94185 (D.C. Cir. 2007).]
15. The Study at 111.
16. The Study.
17. The Study at 55.
18. The Study at 122.
19. The Study at 123.
20. The Study at 109.
21. Morgan Lewis Employee Benefits LawFlash, "DOL Proposed Significant Changes to 'Investment Advice' Fiduciary Status Definition" (November 1, 2010), at http://www.morganlewis.com/pubs/EB_LF_SignificantChangesStatusDefinition_1_01nov20101.pdf.
22. The Study at 109.
23. The Study at 117.
24. FINRA Regulatory Notice 10-54, FINRA Requests Comment on Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship (October 2010), at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf.

25. The Study at 116.
26. The Study.
27. The Study at 117.
28. The Study.
29. The Study at 112.
30. The Study.
31. The Study.
32. The Study at 112 n.511.
33. The Staff stated that "Dodd-Frank Act Section 913(g) requires that the standard of conduct applicable to broker-dealers should be 'no less stringent' than Advisers Act Section 206(1) and (2), and does not refer to Advisers Act Section 206(3). The omission of a reference to Section 206(3) appears to reflect a Congressional intent not to mandate the application of that provision to broker-dealers."
34. The Study at 120.
35. The Study. (*emphasis added*).
36. The Study.
37. The Study.
38. The Study at 120 n.544.
39. The Study at 139.
40. "Developing a uniform registration form in theory could reduce some regulatory burdens by allowing dual registrants to use a single form to register both as broker-dealers and investment advisers. However, about 611 firms are dually registered with the Commission, and most of those that are dual registrants are very large firms in terms of assets and number of employees. Accordingly, only a relatively small number of firms would benefit from the reduced regulatory burdens, and the requirement to complete a new, unified form could increase firms' regulatory burdens, at least on a one-time basis. Finally, a uniform registration form, while potentially simplifying the process for dual registrants (although firms would likely incur costs as they transition to a new form), likely would not enhance investor protection or ameliorate investor confusion and likely would create some level of confusion and increase the burden of compliance for all firms that are not dual registrants." The Study at 136.
41. The Study at 138.
42. The Study at 131.
43. "One of the most significant differences between investment adviser and broker-dealer regulation is that, under certain circumstances, a registered principal of the broker-dealer must approve a communication before distributing it to the public, and certain communications must be filed with FINRA for approval. There are no similar pre-use review and regulatory approval requirements for investment adviser communications." The Study.
44. The Study at 132.
45. The Study at 132, 133.
46. The Study at 135.
47. The Study.