SIFMA Private Client Conference

April 24 - 25, 2013

Key Legal and Regulatory Issues for Private Client Services

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Steven W. Stone*

I. Fiduciary Reform Proposals

A. *Uniform Fiduciary Standard of Care Developments*

1. Section 913 of the Dodd-Frank Act requires that the SEC conduct a study to evaluate the effectiveness of existing legal or regulatory standards of care for providing personalized investment advice and recommendations about securities to retail customers and whether there are legal or regulatory gaps, shortcomings, or overlaps in those legal or regulatory standards.[1]

2. The SEC staff published its Study on Investment Advisers and Broker-Dealers ("IA/BD Study") in early 2011, which recommended, among other things, a uniform fiduciary standard for both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, that is no less stringent than currently applied to investment advisers under the Investment Advisers Act of 1940 ("Adviser's Act").[2]

3. When the IA/BD Study was published, SEC Commissioner Troy Paredes and former Commissioner Kathleen Casey issued a statement expressing concern that the study did not, among other things, appropriately account for the potential overall cost of the recommended regulatory actions.[3]

4. The concerns raised by Commissioners Paredes and Casey may have been prescient, given that about seven months later, the D.C. Court of Appeals issued its decision in Business Roundtable v. SEC.[4] Business Roundtable held that the SEC had violated the Administrative Procedures Act by failing to adequately consider the proxy access rule's effect on efficiency, competition and capital formation as required under Section 3(f) of the Securities

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1 See Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2 See SEC, Staff Study on Investment Advisers and Broker-Dealers (Jan. 2011) available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf ("IA/BD Study").

3 See Statement by SEC Commissioners Troy Paredes and Kathleen Casey: Statement Regarding Study On Investment Advisers And Broker-Dealers (Jan. 21, 2011) available at http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

4 647 F.3d 1144 (2011).

Exchange Act of 1934 ("Exchange Act") and Section 2(c) of the Investment Company Act of 1940 ("Investment Company Act").

5. In a memorandum dated March 16, 2012, the SEC's Office of General Counsel ("OGC") and the Division of Risk, Strategy and Innovation ("RiskFin") provided guidance to staff of the SEC's rule writing Divisions and Offices – the Divisions of Corporation Finance, Investment Management, Trading and Markets – regarding the economic analysis in SEC Rulemakings.[5]

6. The memorandum identified the following as substantive requirements for economic analysis in SEC rulemakings: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs – both quantitative and qualitative – of the proposed action and the main alternatives identified by the analysis.

7. In advance of the nomination hearings Mary Jo White to become the next Chair of the SEC, the SEC published a release, entitled *Duties of Brokers, Dealers, and Investment Advisers,* requesting data and other information, including quantitative data and economic analysis, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers.[6] Comments are due on or before July 5, 2013. Notably, the release covered a wide spectrum of points, including the following:

a. The SEC acknowledged that, under the Advisers Act, the SEC's regulation of advisers as fiduciaries "is largely principles-based."

b. The SEC acknowledged that "since the Advisers Act and Exchange Act were enacted, …the lines between full-service broker-dealers and investment advisers have blurred" and recounted how earlier studies had suggested "that many retail customers who use the services of broker-dealers and investment advisers are not aware of the differences in regulatory approaches for these entities and the differing duties that flow from them."

c. To provide a framework for meaningful public comment, the SEC determined that "consideration of a uniform fiduciary standard of conduct would benefit from a

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[5] See Memorandum from SEC OGC and RiskFin to Staff of SEC Rulewriting Divisions and Offices (March 16, 2012), available at http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf. According to the memorandum, recent court decisions, reports of the U.S. GAO and the SEC's Inspector General's office, and congressional inquiries raised questions about various components of the SEC's economic analysis in rulemakings. See also GAO Report to Congressional Addressees, Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination (Nov. 2011); SEC Office of Inspector General, Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings, Report No. 499 (Jan. 27, 2012).

[6] See SEC, Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013), available at http://www.sec.gov/rules/other/2013/34-69013.pdf. ("March 2013 Release").

set of assumptions and other parameters that commenters can use and critique," but cautioned that "[t]he identification of particular assumptions or parameters, however, does not suggest our policy view or the ultimate direction of any action proposed by us." Among the assumptions and parameters articulated by the SEC are the following:

(i) Concept of "Personalized Investment Advice" -- Assumption that the term "personalized investment advice about securities" would include a recommendation "as interpreted under existing broker-dealer regulation" but would not include "impersonal investment advice" as that term is used under the Advisers Act or "general investor educational tools, provided those tools do not constitute a recommendation under current law."

(ii) Principal Trades -- Assumption that broker-dealers would continue to be permitted to "engage[] in, and receive compensation from, principal trades" and, in that connection, that "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." In that connection, the SEC said that commenters should assume that "to satisfy its obligations under the uniform fiduciary standard of conduct, however, a broker-dealer would need to disclose any material conflicts of interest associated with its principal trading practices" and "any rule under consideration would treat conflicts of interest arising from principal trades the same as other conflicts of interest."

(iii) Scope of Responsibility Set by Agreement -- Consistent with the language of Dodd-Frank, assumption that "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." In that connection, the release includes an assumption that "whether a broker-dealer or investment adviser might have a continuing duty, as well as the nature and scope of such duty, would depend on the contractual or other arrangement or understanding between the retail customer and the broker-dealer or investment adviser, including the totality of the circumstances of the relationship and course of dealing between the customer and the firm, including but not limited to contractual provisions, disclosure and marketing documents, and reasonable customer expectations arising from the firm's course of conduct."

(iv) New Disclosure Regime – Assumption that "any rule under consideration would expressly impose certain disclosure requirement," including (A) a general disclosure principle; (B) "[d]isclosure in the form of a general relationship guide similar to Form ADV Part 2A, to be delivered at the time of entry into a retail customer relationship"; and (C) "[o]ral or written disclosure at the time personalized investment advice is provided of any new material conflicts of interest or any material change of an existing conflict."

(v) Ban on Contests – Assumption that any rule used to implement the uniform standard would "prohibit certain sales contests" – specifically, "the receipt or payment of non-cash compensation (e.g., trips and prizes) in connection with the provision of personalized investment advice about the purchase of securities."

d. Among the many fact finding requests of interest were the following:

(i) The SEC asked"[h]ow do firms that offer both brokerage and advisory accounts advise retail customers about which type of account they should open?"

(ii) The SEC requested substantial data on principal trading practices: "Data and other information describing 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. For each type of security, compare volume and percentage of trades made on a principal basis against the volume and percentage of trades made on a riskless principal basis. Also, provide data and other information on the benefits and costs to broker-dealers and investment advisers of trading securities on a principal basis with retail customers, as well as the benefits and costs to retail customers to buying securities from or selling securities to a broker-dealer or an investment adviser acting in a principal capacity. To the extent possible, describe costs and benefits in terms of dollars paid and/or time spent (e.g., any difference in price for a customer between a principal trade and a trade executed on an agency basis). Do differences in the two regulatory regimes contribute to any differences in the cost of trading securities on a principal basis? If possible, differentiate by retail customer demographic and account information."

(iii) The SEC requested information on client rights to pursue legal claims: "Data and other information related to 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."

(iv) The SEC requested information on conflicts: "Data and other information describing the nature and magnitude of broker-dealer or investment adviser conflicts of interest and the benefits and costs of these conflicts to retail customers. Also provide data and other information describing broker-dealer or investment adviser actions to eliminate, mitigate, or disclose conflicts of interest." The request went on to include use of disclosure to address conflicts: "Data and other information describing the effectiveness of disclosure to inform and protect retail customers from broker-dealer or investment adviser conflicts of interest. Describe the effectiveness of disclosure in terms of retail customer comprehension, retail customer use of disclosure information when making investment decisions, and retail customer perception of the integrity of the information."

e. The SEC also requested public comment on "whether or to what extent we should consider making other adjustments to the regulatory obligations of broker-dealers and investment advisers, including regulatory harmonization."

B. *DOL Fiduciary Proposal*

1. Background:

a. In October 2010, DOL published a proposed rule that would significantly revise the definition of a "fiduciary" under ERISA by rewriting the five-factor test

that has been used since 1975 to determine whether a person is an ERISA fiduciary by reason of giving "investment advice" for a fee.

b. Under the five-part regulatory test for "investment advice," a person can be held to ERISA's fiduciary standards with respect to its advice if such person (1) makes recommendations on investing in, purchasing or selling securities or other property, or gives advice as to their value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan. An investment adviser is not treated as a fiduciary unless each of the five elements of this test is satisfied for each instance of advice.

2. <u>Proposed Regulation</u>:

a. Under the proposal, a person gives fiduciary investment advice if, for a direct or indirect fee, the person provides the requisite type of advice and meets one of four conditions.

b. <u>Requisite Type of Advice</u>: This type of advice includes:

(i) Providing advice, or an appraisal or fairness opinion, concerning the value of securities or other property;

(ii) Making recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property; or

(iii) Providing advice or making recommendations as to the management of securities or other property.

c. <u>Four Conditions</u>: A person that provides the requisite type of advice also must meet one of the following conditions:

(i) The person represents to a plan, participant or beneficiary that the individual is acting as an ERISA fiduciary;

(ii) The person is already an ERISA fiduciary to the plan by virtue of having any control over the management or disposition of plan assets, or by having discretionary authority over the administration of the plan; or

(iii) Provides the advice pursuant to an agreement or understanding that the advice may be considered in connection with investment or management decisions with respect to plan assets and will be individualized to the needs of the plan.

d. <u>Limitations</u>: DOL recognized that certain activities should not result in fiduciary status. These include:

(i) Persons who do not represent themselves to be ERISA fiduciaries, and who make it clear to the plan that they are acting for a purchaser/seller on the opposite side of the transaction from the plan rather than providing impartial advice.

(ii) Employers who provide general financial/ investment information, such as recommendations on asset allocation to 401(k) participants under existing DOL guidance on investment education.

(iii) Persons who market investment option platforms to 401(k) plan fiduciaries on a non individualized basis and disclose in writing that they are not providing impartial advice.

(iv) Appraisers who provide investment values to plans to use only for reporting their assets to the DOL and IRS.

3. Intent to Repropose: On September 19, 2011, DOL announced that it will repropose its pending regulation. DOL has not done so yet.

II. FINRA's Proposed Recruiting Disclosure Rule

A. *Background of SEC Pronouncements – 2009 Letter to CEOs*

1. In an August 31, 2009 letter to chief executive officers of broker-dealers, then SEC Chairman Schapiro expressed concern over the compensation practices that some broker-dealers engage in when recruiting registered representatives from other firms.[7]

2. In particular, the letter stated that certain forms of compensation may carry enhanced risks to customers, such as by leading registered representatives to believe that they must sell securities at a sufficiently high level to justify the special compensation arrangements that they have been given. In this respect, the letter specifically highlighted churning in customer accounts as an area of concern.

3. Prior to this letter, legitimate compensation practices of broker-dealers had been subject to little or no commentary by the SEC. With the exception of perhaps the Penny Stock Rules – which require the disclosure of a registered representative's compensation arrangements when recommending penny stocks[8] – and Form ADV's limited disclosure of differential compensation, neither the SEC nor its staff have directly addressed a registered representative's compensation arrangements.[9] In this regard, it is notable that SEC Rule 206(4)-

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[7] See letter from Mary Schapiro, Chairman, SEC, to Chief Executive Officers of Broker-Dealers (Aug. 31, 2009), available at http://www.sec.gov/news/press/2009/2009-189-letter.pdf.

[8] See 17 C.F.R. §§240.15g-4 and 15g-5.

[9] See also U.S. v. Skelley, 442 F.3d 94, 97 (2nd Cir. 2006) ("…no SEC rule requires the registered representatives who deal with customers to disclose their own compensation, whether pegged to a particular trade or not"); U.S. v. Alvarado, 2001 WL 1631396 at *8 (S.D.N.Y. 2001 ("Neither the SEC nor NASD have required registered representatives of broker/dealers to disclose their own compensation in securities transactions, although both have been aware that registered representatives often received special incentives beyond normal compensation to sell a particular product"), but see Rule 206(4)-3 of the Advisers Act (requiring the disclosure of, among other things, a solicitors compensation arrangement).

3 under the Advisers Act establishes the principle that investment advisers need not disclose to clients the specifics of compensation arrangements with employees who may solicit business for the firm based on the SEC's conclusion that clients can readily understand that firm employees have a financial incentive to bring over new clients. The rule merely requires disclosure of the employee's affiliation with the firm.

B. *FINRA's Recruiting Practices Proposal*

1. In Regulatory Notice 13-02 (published in January 2013), FINRA requested comment on a proposed rule to require disclosure of conflicts of interest relating to recruitment compensation practices.[10] The comment period closed on March 5, 2013, with FINRA receiving over 35 comments.

2. Echoing the concerns raised by former SEC Chairman Schapiro in the 2009 letter, FINRA states in Regulatory Notice 13-02 that recruitment programs raise conflicts of interest that often are not disclosed when registered representatives encourage former customers to move to their new firms. Instead, FINRA notes that registered representatives will address the platforms, products and services offered by the new firms. FINRA believes that customers would benefit from being told of the material conflicts arising from registered representatives being paid recruiting incentives to join new firms.

3. In connection with these concerns, FINRA's proposal would require a member firm (recruiting firm) that provides, or has agreed to provide, enhanced compensation to a registered representative that has been recruited from another firm, to disclose, for one year following the date of the recruitment, the details of such enhanced compensation to any former customer with an account assigned to the registered representative at the previous firm.

a. The disclosure requirement would be triggered when a customer (1) is individually contacted by the recruiting firm or registered representative, either orally or in writing, regarding the registered representative's transfer to the recruiting firm; or (2) seeks to transfer an account from the registered representative's previous firm to a broker-dealer account assigned to the registered representative with the recruiting firm.

4. The proposal would require that the details of the enhanced compensation be made orally or in writing at the time of the first individualized contact by the recruiting firm or registered representative with the former customer but after the registered representative has terminated his or her association with the previous firm.

a. If the disclosure is made orally, or if the customer seeks to transfer the account from the previous firm to the recruiting firm and no individualized contact has occurred, the recruiting firm would be required to provide written disclosure to that customer with the account transfer approval documentation.

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[10] See FINRA, Recruitment Compensation Practices, Regulatory Notice 13-02 (Jan. 2013), available at http://www.finra.org/Industry/Regulation/Notices/2013/P197600.

b. The written disclosure would have to be clear and prominent, and would have to include information with respect to the timing, amount and nature of the enhanced compensation arrangement.

III. Adviser Oversight Developments

A. *SRO for Investment Advisers*

1. In addition to the IA/BD Study, Section 914 of the Dodd-Frank Act requires the SEC to conduct a study to review and analyze the need for enhanced examination and enforcement resources for investment advisers. The staff published its study in January 2011.[11] That study identified three ways to increase examinations of investment advisers: (1) allow the SEC to charge a user fee for exams; (2) establish an SRO for investment advisers; or (3) extend FINRA's reach to include advisers dually registered as brokers. Each option would have required Congressional approval.

2. In April 2012, then House Financial Services Committee Chairman Spencer Bachus introduced a bill that would have put investment advisers under the jurisdiction of an SRO.[12] That bill stalled in the House and has not been reintroduced in the new Congress. In addition, Representative Maxine Waters introduced a bill under which the SEC would have been able to charge fees to investment advisers for exams. That bill also has not been reintroduced in the new Congress.

3. FINRA was making efforts to be the SRO for investment advisers, going so far as to hire Michael Oxley – the former congressman who co-wrote the Sarbanes-Oxley Act of 2002 – as a lobbyist.[13]

4. In February 2013, FINRA CEO Richard Ketchum expressed doubt that a bill giving FINRA jurisdiction over registered investment advisers would make it out of the Financial Services Committee in the foreseeable future.[14] This seemingly signaled the end of FINRA's lobbying efforts, for now.

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[11] See SEC, Staff Study on Enhancing Investment Adviser Examinations (Jan. 2011) available at http://www.sec.gov/news/studies/2011/914studyfinal.pdf.

[12] See Investment Adviser Oversight Act of 2012, H.R. 4624, 112th Cong. (2d Sess. 2012), available at http://www.gpo.gov/fdsys/pkg/BILLS-112hr4624ih/pdf/BILLS-112hr4624ih.pdf.

[13] See Jessie Hamilton, Oxley of Sarbanes-Oxley to Lobby for Financial Self Regulator, Bloomberg (Mar., 18, 2011), available at http://www.bloomberg.com/news/2011-03-18/oxley-of-sarbanes-oxley-to-lobby-for-financial-self-regulator.html.

[14] See Mark Schoeff Jr., Finra calls cease-fire on RIA oversight, InvestmentNews (Feb. 7, 2013), available at http://www.investmentnews.com/article/20130207/FREE/130209953.

B. *Unclear Lines Surrounding the Application of FINRA Rules to Investment Advice*

1. Although FINRA has seemingly halted its effort to become the SRO for registered investment advisers, the application of FINRA's rules to members that are investment advisers and their investment advisory activities remains unclear.

a. Section 19 of the Exchange Act confers on an SRO like FINRA jurisdiction only to enforce the provisions of the Exchange Act and the SRO's rules adopted pursuant to it. Specifically, Section 19(g) of the Securities Exchange Act of 1934 directs an SRO registered under section 19(a) of the Exchange Act to enforce compliance with its own rules, the Exchange Act, and the rules and regulations thereunder.

b. FINRA's jurisdiction does not encompass enforcement of the Advisers Act. The SEC staff has observed that FINRA does not have the authority to enforce compliance with the Advisers Act. Specifically, in its *Study on Enhancing Investment Adviser Examinations* (January 19, 2011), which was mandated by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC staff stated: "FINRA does not, however, have express statutory authority to enforce compliance with the Advisers Act by these firms. These firms are examined for compliance with the Advisers Act exclusively by OCIE…." FINRA has itself acknowledged this point. Stephen Luparello, then-Interim CEO of FINRA, stated in testimony before House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (Apr. 4, 2009) that "FINRA is not authorized to enforce compliance with the Investment Advisers Act [of 1940], Authority to enforce that Act is granted solely to the SEC and to the states. . . . FINRA's authority, as noted above, does not extend to writing rules for, examining for or enforcing compliance with the Investment Advisers Act of 1940." See Testimony by Stephen Luparello, Interim CEO of FINRA, before House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (Apr. 4, 2009).

c. Courts have ruled that FINRA rules do not apply to dual registrant when acting as an investment adviser (nor broker-dealer. See, e.g., Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc., 264 F.3d 770 (8th Cir. 2001) ("We do not believe that the NASD Rules were meant to apply to every sort of financial service an NASD member might provide, regardless of how remote that service might be from the investing or brokerage activities, which the NASD oversees."); Bakas v. Ameriprise Financial Services, Inc., 651 F. Supp. 997 (D. Minn. 2009) (holding that Ameriprise was not bound by the FINRA Code of Arbitration, therefore could compel the plaintiff to arbitrate claims and enforce its contractual class action ban against the plaintiff despite FINRA rules to the contrary and stating "this Court does not believe that a broker/dealer that also happens to be an investment adviser necessarily subjects itself to FINRA's rules for all of its activities—including those undertaken in its capacity as an investment adviser— simply by joining FINRA. Such a conclusion would stretch FINRA's power beyond its limits, as it enjoys no statutory authority over investment advisers."); *cf.* Wachovia Bank, Nat'l Ass'n v. Schmidt, 445 F.3d 762, 768 (4th Cir.2006) (noting that plaintiff's claims arose solely out of adviser-advisee relationship between investment adviser and plaintiff, even though adviser also served as lender to plaintiff; "Wachovia's two roles as lender and adviser were distinct.")

d. On the other hand, some of FINRA's rules are fairly broad. For example, FINRA Rule 2010 provides FINRA with the authority to enforce "just and equitable

principles of trade" with respect to member firms and associated persons. In addition, FINRA recently amended Rule 8210 to clarify the scope of its authority to inspect and copy the books, records and accounts of member firms, associated persons and persons subject to FINRA's jurisdiction.[15] The amendments to Rule 8210 clarify that the inspection right covers information that is in the "possession, custody or control" of the member firm, its associated persons and persons over whom FINRA has jurisdiction. As modified, including in accompanying Supplementary Material, the scope of books, records and accounts covered by the rule "includes but is not limited to records relating to a FINRA investigation of outside business activities, private securities transactions or possible violations of just and equitable principles of trade, as well as other FINRA rules, MSRB rules, and the federal securities laws." The Supplementary Material also provides that the rule "does not ordinarily include books and records that are in the possession, custody or control of a member or associated person, but whose bona fide ownership is held by an independent third party and the records are unrelated to the business of the member. The rule requires, however, that a FINRA member, associated person, or person subject to FINRA's jurisdiction must make available its books, records or accounts when these books, records or accounts are in the possession of another person or entity, such as a professional service provider, but the FINRA member, associated person or person subject to FINRA's jurisdiction controls or has a right to demand them." FINRA Rule 8210 & Supplementary Material .01.

2. *Specific Areas*

a. Communications with the Public -- Where a dual registrant acts both adviser and broker, FINRA has staked a claim to regulating the activity and related client communications, and this is reflected in FINRA staff pronouncements. The most definitive guidance the FINRA staff has issued on the reach of Rule 2210 to investment advisory communications is the 15-year old letter the FINRA staff sent to Dawn Bond at FSC relating to marketing materials for advisory programs. *See* Dawn Bond Letter, FINRA Interpretative Letter (July 30, 1998). In that letter, the FINRA staff noted that it "has not required the filing of marketing materials that are used exclusively to solicit on behalf of an advisory business." (Emphasis added.) Then, the FINRA staff layered in the following conditions:

(i) The materials had to genuinely promote the advisory services (they had to "purport to solicit customers for investment advisory services");

(ii) The materials could not "contain references to mutual funds, variable annuities or other securities"; and

(iii) The materials could not be used to solicit customers for brokerage programs or arrangements (including wrap fee programs) "in which the member or its registered representatives participate in the execution of securities transactions and receive transaction-based compensation in lieu of or [in] addition to an advisory fee."

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15 See, e.g., FINRA, FINRA's Information and Testimony Requests, Regulatory Notice 13.06 (Jan. 2013), available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p197763.pdf.

(iv) In the FINRA staff's view, if a dually registered broker-dealer and advisory representative engages in preparing a financial plan for a fee, NASD rules apply if "particular securities are recommended or securities transactions are being executed through [the broker-dealer] by customers who purchased the plan."

b. Trade Reporting -- Under FINRA's trade reporting rules, FINRA takes the stance, generally, that when an investment adviser is part of the same legal entity as a broker-dealer, any trades by the investment adviser are considered the broker-dealer's trades for trade-reporting purposes. When an investment adviser is a separate legal entity that is not a FINRA member, the investment adviser would not be subject to trade-reporting rules.[16]

IV. Advisory Account Issues

A. *Renewal of Advisers Act Rule 206(3)-3T*

1. In December 2012, the SEC extended the sunset date of Advisers Act Rule 206(3)-3T from December 31, 2012 to December 31, 2014.[17]

2. Rule 206(3)-3T allows investment advisers that are registered as broker-dealers to sell securities held in their proprietary accounts to advisory clients in compliance with Section 206(3) of the Advisers Act without requiring transaction-by-transaction written disclosures and consent.

3. Under Rule 206(3)-3T, a dual-registrant may sell securities to an advisory client from the firm's proprietary account if the firm provides the client with oral disclosure of the firm's capacity, obtains the client's oral consent prior to executing the trade, and meets certain other requirements.

4. Many large dual registrants currently rely on Rule 206(3)-3T to provide clients with access to less liquid securities that may not be available on the open market or are only available on an agency basis at a higher price. Without Rule 206(3)-3T, many firms would be unable to comply with the requirements of Section 206(3) and would be unable to offer certain less-liquid securities to clients.

5. In deciding to extend Rule 206(3)-3T, the SEC cited, among other factors, its ongoing review of the regulation of investment advisers and broker-dealers following the IA/BD Study. This suggests that the SEC may revisit Rule 206(3)-3T within the context of its broader initiatives regarding the regulation of broker-dealers and investment advisers in the context of the March 2013 Release.

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[16] See FINRA, Trade Reporting Frequently Asked Questions (FAQ), Q&A 106.2 , available at http://www.finra.org/Industry/Regulation/Guidance/p038942.

[17] See Advisers Act Release. No. 3522 (Dec. 20, 2012), 77 Fed. Reg. 76,854 (Dec. 31, 2012).

B. *Emerging Gaps in Guidance Relevant to Private Client Services, especially Non-Discretionary Advice*

1. SEC and staff guidance and precedent under the Advisers Act pertains largely to discretionary accounts for which advisers have greater fiduciary responsibilities and, as the SEC observed in the March 2013 Release, SEC and staff guidance in this area is largely principle based. By contrast, there is currently no existing framework that definitively articulates the standard of care for investment advisers providing non-discretionary investment advice, including in the private client setting. While the standard under the Advisers Act for discretionary advice may be relevant and have often been the pot of reference for SEC examiners, it is by no means dispositive.

a. The scope of fiduciary duty turns on the nature and scope of the fiduciary relationship, which itself is a function of the scope of the fiduciary's authority to act for the client and the client's reliance on the adviser to do so. In short, whether a firm has discretion to act for a client, as compared to merely making recommendations, makes an important difference in sizing up the scope and nature of the firm's obligations.

b. Although this important distinction has yet to be reflected in guidance under the Advisers Act, it is recognized in other parallel bodies of law. For example, in the banking area, "[u]nder common law, nondiscretionary accounts, where the bank only offers investment advice and recommendations, are generally considered to be agency accounts with lesser duties being imposed upon the bank." Although various banking regulators differ in how they articulate the responsibilities of banks offering non-discretionary fiduciary services, the FDIC, for example, distinguishes between a bank's duties when a bank acts with investment discretion and when it acts without discretion.

2. While the standard under the Advisers Act for discretionary advice may be relevant, it is by no means dispositive. This point is best made by Tom Lemke and Gerry Lins in the most recent edition of one of their treatises: "[T]he fiduciary standard of the Advisers Act . . . is incomplete when it comes to the obligations of financial professionals who provide non-discretionary investment advice to retail investors. Indeed, while the current Advisers Act regulatory scheme provides extensive guidance on discretionary relationships, it provides virtually no specific guidance as to what conduct is expected from an investment adviser who provides non-discretionary advice to retail investors. . . . While it may seem attractive to simply apply the standards for discretionary relationships to include non-discretionary relations, in fact this approach seems impractical and simply would not provide an effective regulatory approach for non-discretionary relationships (a result acknowledged by the terms of Dodd-Frank)."[18]

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[18] Thomas P. Lemke & Gerald T. Lins, *Regulation of Financial Planners* § 3:12 at 3-38 (West 2012).