FIDUCIARY: A HISTORICALLY SIGNIFICANT STANDARD

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I. Introduction

In July 2010, the U.S. Securities and Exchange Commission ("SEC") began the process of conducting a study on the effectiveness of the standards of care for broker-dealers and investment advisers.[1] The results of the study are expected to lay the groundwork for potential rulemaking by the SEC related to a fiduciary standard of care for all investment advice providers, as authorized under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[2] As a part of this process, investment professionals and firms have engaged in a broad debate regarding appropriate standards of care for broker-dealers and investment advisers.[3] Many professionals and firms engaged in this debate,

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1 Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 62,577, 75 Fed. Reg. 44,996 (July 30, 2010).

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Each primary financial regulatory agency may impose . . . standards . . . with respect to those entities for which it is the primary financial regulatory agency . . . .").

3 *See* Study Regarding Obligations of Brokers, Dealers, and Investments Advisers, *supra* note 1 at 44,996 (requesting public comment in connection with the SEC's public study to evaluate "[t]he effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, and persons associated with them when providing personalized investment advice and recommendations about securities to retail customers" and whether there are "gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for these intermediaries."). As of August 30, 2010, the Commission received over 2,500 responses. *See Comments on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, SEC.GOV,

however, have failed to recognize the historically significant status of the fiduciary standard and why promoting such a standard is central to ensuring investor protection.

The concept of serving as a fiduciary is not new. In fact, centuries of law and business illustrate the importance of the concept. This paper illustrates the timelessness of the fiduciary standard through a review of how fiduciary principles have been recognized and enforced throughout history. As will be shown, law and society have established the fiduciary standard as the essential code of conduct for those entrusted to care for the property of others.

The firmly established history of the fiduciary standard should serve as a useful guide to the SEC and other regulators when promulgating rules that codify the fiduciary standard under the federal securities laws. Moreover, this history reveals three key principles for regulators to consider as they provide guidance on the application of the fiduciary standard: (1) fiduciary matters, including advice, demand a higher standard than normal marketplace transactions, such as sales of securities; (2) exceptions to the fiduciary standard undermine the fiduciary duty of loyalty; and (3) those charged with interpreting and enforcing the fiduciary standard should not consciously weaken it.[4]

II. A Historical Standard

Under the federal securities laws, investment advisers have long been regulated as trusted advisors subject to the fiduciary standard while broker-dealers have been regulated as salespeople subject to a fair dealing standard.[5] The fair dealing standard is considered a commercial standard that arises when a broker-dealer holds itself out as willing to transact with investors.[6] By entering the

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http://www.sec.gov/comments/4-606/4-606.shtml (last visited Nov. 7, 2010).

[4] *See* Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) ("Many forms of conduct permissible. . . for those acting at arm's length, are forbidden to those bound by fiduciary ties. . . . [T]he punctilio of an honor the most sensitive, is then the standard of behavior . . . .").

[5] *See* Kristina A. Fausti, *A Fiduciary Duty for All?*, 12 DUQ. BUS. L.J. 183, 185-90 (2010).

[6] *Id.* at 187 ("Both the SEC and FINRA standards of care have long been viewed as commercial standards that reflect the role of broker-dealers as salespeople in the investment marketplace.").

investment marketplace, the broker-dealer is deemed to warrant that it will deal and transact fairly with all of its customers.[7] In contrast, the fiduciary standard has been viewed to go beyond fair dealing because of the unique nature of the relationship between an investment adviser and investor. As Professor Tamar Frankel explains, "at the heart of fiduciary relationships is *entrustment of property or power* that clients hand over to their fiduciaries in order to enable fiduciaries to perform a service to them."[8] Moreover, fiduciaries provide socially important expert services to "entrustors" that require a high level of expertise.[9]

These concepts of trust and expert service underlying fiduciary relationships have a long history within many different societies.[10] Historians have traced the roots of fiduciary principles back to the Code of Hammurabi (ca. 1790 BC) in Babylon.[11] Hammurabi established one of the first written codes of law and set forth the rules governing the behavior of agents entrusted with property, demonstrating fiduciary considerations at the very beginning of recorded legal history.[12] Like the Code of Hammurabi, most primitive law deals with the entrusting of property for safekeeping, pledges of good faith and other indicia of trust.[13]

In the Judeo-Christian tradition, fiduciary principles can be traced to both the Old and the New Testament.[14] For example, courts have linked the fiduciary duty of loyalty to the biblical principle that

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[7] *Id*. at 187-88.
[8] Tamar Frankel, *Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers* 3 (Boston Univ. Sch. of Law Working Paper No. 09-36, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1446750.
[9] *Id.* ("Fiduciaries provide socially important expert services to 'entrustors' (and society) such as professional services (law, medicine, financial services).").
[10] *See* Blaine F. Aikin, *The Role of Fiduciaries is Timeless*, INVESTMENT NEWS, Aug. 15, 2010, http://www.investmentnews.com/ article/20100815/ REG/308159995 (citing various texts from civilizations throughout recorded history which recognize many of the principles underlying the fiduciary relationship).
[11] Joseph F. Johnston, Jr., *Natural Law and the Fiduciary Duties of Business Managers*, 8 J. MKTS & MORALITY 27, 29 (2005).
[12] *Id.*
[13] *Id.*
[14] *Id*.

no person can serve two masters.[15] Chinese historical texts also recognize fiduciary principles of trust and loyalty.[16] One of the three basic questions of self-examination attributed to Confucius (551 BC–479 BC) asks: "In acting on behalf of others, have I always been loyal to their interests?"[17] Modern Chinese law also recognizes such fiduciary concepts.[18]

Aristotle (384 BC–322 BC) consistently recognized that in economics and business, people must be bound by high obligations of loyalty, honesty and fairness and that society suffers when such obligations are not required.[19] The Romans refined and formalized fiduciary law even further. In fact, the term "fiduciary" originated in Roman law, and means "'a person holding the character of a trustee, or a character analogous of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires.'"[20] Cicero (103 BC–46 BC) noted the relationship of trust between an agent and principal (known to Romans as mandatory and mandator, respectively), and emphasized that an agent who shows carelessness in his execution of trust behaves very dishonorably and "is undermining the entire basis of our social

[15] *Id.* at 29 & n.4 (citing Pepper v. Litton, 308 U.S. 295, 311 (1939); United States v. Miss. Valley Generating Co., 364 U.S. 520, 549, 550 n.14 (1961) ("The moral principle upon which the statute is based has its foundation in the Biblical admonition that no man may serve two masters, . . . a maxim which is especially pertinent if one of the masters happens to be economic self-interest.")).

[16] Johnston, *supra* note 11, at 29 ("The ethical norms arising from relationships of trust and confidence are not limited to Western societies[;] . . . Chinese history, for example, reflects a similar fiduciary principle.").

[17] *Id.*

[18] *Id.* (citing THE GREAT QING CODE 162 (William C. Jones trans., 1994) (providing for criminal punishment for one who receives deposit of property of another and consumes such property without authority); BASIC PRINCIPLES OF CIVIL LAW IN CHINA 317, 321 (William C. Jones ed., 1989) (recognizing "contracts of entrustment" and an obligation of brokers to act "honestly, justly, in good faith, and not in a way contrary to the notion of fairness.").

[19] *See*, *e.g.*, James O'Toole, *Advice from Aristotle*, http://www.scu.edu/ethics/publications/submitted/otoole/business-ethics-aristotle.html.

[20] Ron A. Rhoades, *What are the Specific Fiduciary Duties of Financial Advisors?* Jan. 1, 2008, at 2, http://www.fiduciarynow.com/WhatAreTheSpecificFiduciaryDutiesofFinancialAdvisors.pdf (citing BLACK'S LAW DICTIONARY (5th Ed. 1979)).

system."[21] Moreover, Cicero noted that, "legal proceedings for betrayal of a commission [agency] are established, involving penalties no less disgraceful than those for theft."[22]

Fiduciary relationships have also "occupied a significant body of Anglo-American law and jurisprudence for over 250 years."[23] These fiduciary duties "originated in [courts of] Equity."[24] Courts of Equity granted relief in numerous circumstances involving one person's abuse of confidence and, over time, concrete rules and precise terms related to fiduciary relationships began to form as Equity evolved.[25] In fact, "[t]he term 'fiduciary' itself was adopted to apply to situations falling short of 'trusts,' but in which one person was nonetheless obliged to act *like* a trustee."[26]

In 1928, Justice Benjamin Cardozo's seminal opinion in *Meinhard v. Salmon* articulated fiduciary obligations under modern U.S. law. In part, Justice Cardozo stated:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden

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21 Johnston, *supra* note 11, at 30.

22 Marcus Tullius Cicero, THE ORATION FOR SEXTUS ROSCIUS OF AMERIA (Charles Duke Yonge, trans., London, G. Bell and Sons, 1916), *available at* http://oll.libertyfund.org/?option=com_staticxt&staticfile=show.php%3Ftitle=570&chapter=87171&layout=html&Itemid=27.

23 Robert Cooter & Bradley Freeman, *An Economic Model of the Fiduciary's Duty of Loyalty*, 297 Tel AVIV UNIV. STUD. L. 297, 298 (1990) (citing Keech v. Sanford (1726), Sel. Cas T. King 61; 25 E.R. 223), *available at* http://works.bepress.com/cgi/viewcontent.cgi?article=1055&context=robert_cooter).

24 Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 880 (Nov. 1988) (citing Sealy, *Fiduciary Relationships,* 1962 CAMBRIDGE L.J. 69, 69-72).

25 *Id.*

26 *Id.*

> by the crowd. It will not consciously be lowered by any judgment of this court.[27]

Justice Cardozo's opinion has been cited widely in U.S. jurisprudence and academic and professional writing.[28] It is also worth noting that while fiduciary principles mostly developed in common law in the U.S., they have also been codified in statutes, as discussed further *infra*.

III. Defining Fiduciary

The review of various societies' views on relationships of trust reveals that concepts of fiduciary responsibility have been established since primitive law and have withstood the test of time. With the introduction of regulatory reform this past year, however, some advocates for rulemaking would like to ignore this strong history and rewrite fiduciary duties.

On June 17, 2009, the Obama Administration issued its framework for financial regulatory reform, which declared that "[s]tandards of care for all broker-dealers when providing investment advice about securities to retail investors should be raised to the fiduciary standard to align the legal framework with investment advisers."[29] A little more than one year later, the Dodd-Frank Act gave the SEC the authority to adopt rules promulgating a fiduciary duty for both broker-dealers and investment advisers.[30]

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[27] Meinhard v. Salmon, 164 N.E. 545, at 546 (N.Y. 1928) (citation omitted).

[28] *See*, *e.g.,* N.L.R.B. v. Amax Coal Co., 453 U.S. 322, 330 (1981); S.E.C. v. Chenery Corp., 318 U.S. 80, 98 (1943) (Black, J., dissenting); Big Rivers Electric Corp. v. Schilling (*In re* Big Rivers), 355 F.3d 415, 436 (6th Cir. 2004); NCAS Realty Mgmt. Corp. v. Nat'l Corp. for Hous. P'ships, 143 F.3d 38, 39 (2d Cir. 1998); Bennett v. Bennett (*In re* Bennett), 989 F.d2 779, 789-90 (5th Cir. 1993); Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 493 (Dec. 2009).

[29] U.S. DEPARTMENT OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 71 (2009), *available at* http://financialstability.gov/roadtostability/regulatoryreform.html.

[30] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(f)-(g), 124 Stat. 1376, 1827-30 (2010) (authorizing the SEC to "commence a rulemaking, as necessary or appropriate . . . to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated

While investment advisers have long been subject to a fiduciary standard under the Investment Advisers Act of 1940 ("Advisers Act"), broker-dealers have only been held to a fair dealing standard under the Securities Exchange Act of 1934, even when they provide investment advice services.[31] Because broker-dealers have not been regulated as fiduciaries in the past, soon after the release of the Administration's framework in 2009, members of the brokerage industry began to question the definition and meaning of "fiduciary."[32] As the industry and its regulators have identified and debated these questions, investment intermediaries have become increasingly concerned over how the SEC will define and apply fiduciary concepts.

Those questioning the meaning of fiduciary argue that it has been defined differently across U.S. federal and state law.[33] However, such arguments ignore key points about the framework of fiduciary obligations. In the evolution of law from Roman times through the present, the fiduciary standard has embodied the core duties of loyalty (placing beneficiaries interests first), due care (prudence and competence) and good faith (honest intentions, full

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with investment advisers for providing personalized investment advice about securities to such retail customers . . ." and authorizing the SEC to establish a fiduciary duty for brokers and dealers, respectively).

[31] There is a so-called "broker exemption" in the Advisers Act for broker-dealers who provide advice that is "solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor . . . ." Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11) (2006); *see also* Fausti, *supra* note 5, at 186-187 (paraphrasing two key components of the "broker exemption" in the Investment Advisors Act of 1940).

[32] *See Industry Groups Differ on Fiduciary Standard*, FINANCIAL ADVISOR, Oct. 6, 2009, http://www.fa-mag.com/fa-news/4532-industry-groups-differ-on-fiduciary-standard-.html.

[33] *See Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Comm'n on Financial Services*, 111th Cong. 22 (2009) (statement of Randolph C. Snook, Executive Vice President of the Securities Industry and Financial Markets Association), *available at* http://www.house.gov/apps/list/hearing/financial svcs_dem/snook.pdf; *see also Industry Groups Differ on Fiduciary Standard, supra* note 33 (reporting divergent approaches to the fiduciary standard, which "have governed the two sides for nearly 70 years," for which investment advisers and broker-dealers advocate).

disclosure and applied diligence).[34] Moreover, throughout the development of common law, courts have imposed a high standard of morality upon fiduciaries.[35] Thus, "[l]oyalty, fidelity, faith and honor form fiduciary law's basic vocabulary."[36] Furthermore, courts and regulators have gone further to explain that the fiduciary duty goes beyond basic concepts of honesty, good faith and fair dealing, and prohibits any professional from taking unfair advantage of an investor's trust.[37]

Distinctions in fiduciary functions better explain any differences in laws themselves. The historical development of fiduciary law by courts and a function-based approach by regulators suggest that it is not the definition of fiduciary that varies, but rather

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[34] Scott Thomas FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 308-10 (1999) (citing Birnbaum v. Birnbaum, 539 N.E.2d 574, 576 (N.Y. 1989):

> [I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. This is a sensitive and 'inflexible' rule of fidelity . . . requiring avoidance of situations in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty . . . . [A] fiduciary . . . is bound to single-mindedly pursue the interests of those to whom a duty of loyalty is owed . . . ." (citations omitted).

[35] Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 829-30 (1983).

[36] *Id*. at 830 (citation omitted).

[37] Meinhard v.Salmon, 164 N.E. 545, 546 (1928) ("A trustee is held to something stricter than the morals of the market place. Not honestly alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."); *see* ROBERT E. PLAZE, DIVISION OF INVESTMENT MANAGEMENT, U.S. SEC. & EXCH. *COMM'N*, THE REGULATION OF INVESTMENT ADVISERS BY THE SECURITIES AND EXCHANGE COMMISSION 13 (Nov. 22, 2006) (describing the fiduciary duty owed to clients by a registered investment adviser as prohibiting, among other things, "taking unfair advantage of a client's trust" and stating that "[a] fiduciary owes its clients more than mere honesty and good faith alone"); *see also* SEC Chairman Mary L. Schapiro, Address at the New York Financial Writers' Association Annual Awards Dinner (June 18, 2009), *available at* http://www.sec.gov/news/speech/2009/spch061809mls-2.htm (arguing that "a fiduciary owes its customers and clients more than mere honesty and good faith alone" and "must at all times act in the best interest of customers or clients.").

the role the fiduciary plays and the related level of trust involved in the relationship that drives differences in requirements and prohibitions prescribed by laws and regulations. For example, courts traditionally developed fiduciary law by defining various relations as fiduciary and designing rules for those relations.[38] Statutes have similarly sought to set rules based on the roles of fiduciaries. Accordingly, the Employee Retirement Income Security Act ("ERISA") sets requirements and prohibitions based on the role of a fiduciary for a qualified retirement plan,[39] the Uniform Prudent Investor Act ("UPIA") addresses the role of a fiduciary serving private trusts,[40] and the Advisers Act governs investment advice fiduciaries.[41] Notwithstanding the context of the fiduciary relationship and the applicable functional requirements, trust, loyalty, due care and good faith always remain at the foundation.

With regard to investment advice, SEC Commissioner Luis Aguilar has recognized that "the fiduciary relationship between an

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[38] Frankel, *supra* note 35, at 804-805:

> This method of developing the law was adequate in the past because new types of fiduciaries were recognized gradually over the centuries. The 'use' emerged during the twelfth and thirteenth centuries in England, and the trust developed over the fourteenth through seventeenth centuries. Partnerships appeared in the sixteenth century, and evolved into joint stock companies and corporations. Emancipated servants and employees emerged from domestic relations law to become agents and factors. It was therefore sufficient to describe an arrangement, call it fiduciary, and decide on appropriate rules." (citations omitted).

[39] Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (2006) (establishing requirements and prohibitions applicable to persons named as fiduciaries in employee benefit plan documents and to persons considered fiduciaries for the purposes of the Act based on their conduct and authority).

[40] NATIONAL CONFERENCE OF COMM'RS ON UNIFORM STATE LAWS, UNIFORM PRUDENT INVESTOR ACT (Apr. 18, 1995), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/upia94.pdf (discussing the regulation of investment responsibilities of trustees arising under the Uniform Prudent Investor Act).

[41] Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to b-21 (2006) (imposing a fiduciary duty on investment advisers).

investment adviser and its client is a bedrock principle that underpins the Advisers Act."[42] In fact, in 1963, the U.S. Supreme Court stated that the Advisers Act "reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."[43] Commissioner Aguilar has further noted that "[t]he fiduciary standard is a dynamic, living principle that provides investors with true protection."[44]

The SEC Investor Advisory Committee's Investor as Purchaser Subcommittee (the "Subcommittee") has also recognized a federal fiduciary standard under the Advisers Act.[45] In a February 2010 memo, the Subcommittee noted that statutes, SEC rules and common law principles comprise an important aspect of the SEC's

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[42] Luis A. Aguilar, SEC Comm'r, SEC's Oversight of the Adviser Industry Bolsters Investor Protection, Address at the Investment Advisers Association Annual Conference (May 7, 2009), http://www.sec.gov/news/speech/2009/spch050709laa.htm.

[43] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191—92 (1963) (quoting 2 LOUIS LOSS ET AL., SECURITIES REGULATION (2d ed. 1961), 1412).

[44] Aguilar, *supra* note 42:

> There is only one fiduciary standard and it means that a fiduciary has an affirmative obligation to put a client's interests above his or her own. As a result, a fiduciary acts in the best interests of the client, even if it means putting a client's interest above his own . . . . A fiduciary standard has real teeth because it is an affirmative obligation of loyalty and care that continues through the life of the relationship between the adviser and the client, and it controls all aspects of their relationship. It is not a check-the-box standard that only periodically applies.

[45] Press Release, Sec. and Exch. Comm., SEC Investor Advisory Committee Forms Subcommittees to Tackle Ambitious Agenda on Behalf of Investors (Sept. 15, 2009), http://www.sec.gov/news/press/2009/2009-197.htm (announcing the formation of a subcommittee to "consider the fiduciary duty owed to investors by those who provide investment advice").

role in developing and implementing the federal fiduciary duty.[46] The Subcommittee also noted that while the federal fiduciary duty applies only under the Advisers Act, a non-federal fiduciary duty may apply nonetheless in other contexts outside of the Advisers Act, such as under state common law and state securities laws.[47]

IV. Fiduciary Application

Ultimately, the application of the fiduciary standard to all investment advice providers, including broker-dealers, will have serious practical implications for how the investment industry as a whole operates. A primary goal of regulatory reform, and the more broad application of the fiduciary standard, has been to enhance investor protection.[48] In order to achieve this goal of enhancing investor protection, regulators should rely on three key principles from Justice Cardozo's opinion in *Meinhard v. Salmon*. First, those acting in a fiduciary capacity are subject to a higher standard than those acting at arm's length within the investment marketplace. Second, exceptions to fiduciary obligations only promote "disintegrating erosion" of the duty of undivided loyalty. And third, the fiduciary standard has been protected and maintained over time by courts and other legal guardians unwilling to lower it.

Many members of the brokerage industry have used the concept of harmonized regulation[49] to rationalize proposals for new

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[46] Memorandum from the Investor as Purchaser Subcommittee to the SEC Investor Advisory Committee 2 (Feb. 15, 2010), http://www.sec.gov/spotlight/invadvcomm/iacmemofiduciaryduty.pdf.

[47] *Id.* at 7. Moreover, the Subcommittee recognized that SEC action can greatly impact the scope and substance of non-federal fiduciary duties; such action may range from informally guiding parties in their application of the fiduciary duty to formally preempting a conflicting standard. *Id.* at 8. On the other hand, SEC inaction could leave room for other actors and entities, such as state and federal courts, state regulators, FINRA, and arbitration panels to fill the fiduciary space. *Id.* at 8-9 ("[I]naction may leave the fiduciary space open to be filled by a variety of actors . . . .").

[48] *See* FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION, *supra* note 29, at 55 (recognizing that Congress, the President, and financial regulators took "significant measures to address . . . inadequacies in our consumer protection framework" and proposing further "comprehensive reform").

[49] The Administration's framework for regulatory reform called for legislators and regulators to "harmonize" the investment adviser and broker-

(and arguably diluted) standards of care that would address varying business and service models of investment intermediaries.[50] These alternative standards, however, place greater emphasis on accommodating special interests and promoting concepts of fair dealing (the standard traditionally applied to broker-dealers) rather than fiduciary concepts of loyalty, due care and utmost good faith.[51] In order to protect fiduciary principles and investors, the SEC should view the proposals for harmonized regulation and alternative standards of care in light of the three aforementioned considerations articulated in Justice Cardozo's opinion in *Meinhard v. Salmon.* Such a review reveals that: (1) the proposed alternative standards that promote fair dealing are not as high as the fiduciary standard; (2) requests for exceptions that address different business models will

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dealer regulatory regimes. *Id.* at 71 (proposing to "[e]stablish a fiduciary duty for broker-dealers . . . and harmonize the regulation of investment advisers and broker-dealers"). The framework also notes that the SEC should be permitted to align duties for financial professionals across financial products. *Id.* The recommendation put forth by the Obama Administration to harmonize investment adviser and broker-dealer regulatory schemes and extend the fiduciary duty to all investment advice providers likely originated within the walls of the SEC. *See* Fausti, *supra* note 5, at 197-99 (citing early SEC support for the fiduciary measure resulting from conclusions in the RAND Report and public statements by the SEC as indications that the Obama Administration's recommendations likely originated within the SEC).

[50] Letter from Dale E. Brown, President & CEO, Financial Services Institute to Elizabeth M. Murphy, Secretary, Sec. and Exch. *Comm'n.* 3-4 (Aug. 30, 2010), http://www.sec.gov/comments/4-606/4606-2687.pdf (advocating for a universal fiduciary standard of care that is "carefully designed to promote universal access to advice, presser investor choice, and enhance investor protection"); *Enhancing Investor Protection and the Regulation of Securities Markets*: *Hearing Before the U.S. Senate Committee on Banking, Housing and Urban Affairs*, 111th Cong. 5 (Mar. 10, 2009) (statement of T. Timothy Ryan, Jr., President and Chief Executive Officer, Securities Industry and Financial Markets Association) (arguing that fiduciary standards "should be crafted so as to be flexible enough to adapt to new product and services as well as evolving market conditions . . . ."), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76&Witness_ID=f2cf02f4-d63e-4bd0-a16c-3786fbc08c19).

[51] *See* Aguilar, *supra* note 42 (expressing "great concern" that proposals define "standards of suitability" and would dilute "the existing high fiduciary standard).

only serve to erode the foundation of trust and loyalty that have withstood the test of time; and (3) the SEC, as the primary overseer and enforcer of the fiduciary standard for investment intermediaries, should not consciously weaken the fiduciary standard by granting requests for alternative standards or exceptions.

A more practical regulatory approach that would honor the standards set forth by Justice Cardozo would seek to align and coordinate existing and new regulatory rules in a way that complements, but does not erode, the principles-based fiduciary standard. SEC Chairman Mary Schapiro and Commissioner Elisse Walter have both supported the application of a consistent fiduciary standard of conduct and have noted the importance of adopting rules to address the varied roles and functions of different investment intermediaries—an approach consistent with how fiduciary roles traditionally have been defined in law throughout time. Under such a regulatory regime, the principles-based fiduciary standard would guide professional conduct and enhance enforcement, while clear and strong rules would draw lines for behavior and prevent abuse.[52] However, where rules do not address specific behavior, investment intermediaries would be expected to honor and default back to fiduciary principles, placing their client's interests first.

V. Conclusion

Implementing a fiduciary standard for all advice providers will take time and will not necessarily cure all regulatory issues. As the SEC seeks to bring more clarity and consistency to the obligations of investment intermediaries, the SEC will have to contemplate distinctions between investment advice providers and product providers. In addition, other issues regulators must address

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[52] The North American Securities Administrators Association ("NASAA") has best articulated the need for balancing principles and rules. *See* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, PROCEEDINGS OF THE NASAA FINANCIAL SERVICES REGULATORY REFORM ROUNDTABLE: A MAIN STREET AGENDA FOR WALL STREET REFORM 11-12 (Dec. 11, 2008), http://www.nasaa.org/content/Files/Proceedings_NASAA_Regulatory_Reform_Roundtable.pdf (arguing that if "the fundamental cornerstone of [regulatory reform] is that the customer comes first," then such a system may avoid problems associated with the "tortured construct" distinguishing brokers from investment advisers instead of viewing the two as functionally equivalent).

include: (1) tailoring guidance around the Advisers Act exemption for advice "solely incidental" to brokerage business;[53] (2) setting requirements for inherently conflicted brokerage activity such as sales activity for initial public offerings ("IPOs");[54] and (3) determining whether interactions with institutional and retail clients warrant similar regulatory treatment.[55] None of these issues have easy solutions.

Ideally, the SEC will codify the definition of fiduciary and recognize the historical significance of fiduciary principles as the agency engages in rulemaking. As lobbying efforts by special interests increase in the coming months, however, there is a real risk that investment intermediaries and regulators will get caught up in a game of semantics and lose sight of investor protection goals. The solution ultimately lies in helping regulators focus on three key facts: (1) investors are under the serious misconception that all investment professionals are equally accountable to serve investors' best interests;[56] (2) the existing fiduciary standard is rooted in a strong foundation of loyalty, due care and good faith; and (3) upholding these time-honored fiduciary principles and extending them to all

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[53] *See* Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11).

[54] The securities industry has argued that broker-dealers would lose their ability to sell IPOs to individual investors if broker-dealers are subject to the fiduciary standard. *See Fiduciary Standard May Imperil IPOs at Retail Brokerages,* INVESTMENT NEWS, Apr. 15, 2010, http://www.investmentnews.com/article/20100815/REG/308159981.

[55] The Dodd-Frank Act primarily addresses the fiduciary standard in the context of personalized investment advice provided to retail investors. The legislation, however, gives the SEC authority to impose a fiduciary standard for investment advice services provided to other investors as well. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(g), 124 Stat. 1376, 1829-30 (2010).

[56] *See* ANGELA A. HUNG ET. AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 89-90 (2008), http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (finding that "[r]espondants were slightly more likely to report [the belief] that investment advisers rather than brokers are required to act in the client's best interest. . . ." and that "these differences . . . are statistically significant"). This report by the RAND Corporation showed that investors struggle to understand the different legal standards of care to which investment advisers and broker-dealers are held. *Id.* In fact, the report seems to support a conclusion that most investors are under the impression that all financial professionals have an obligation to put investors' interest first. *Id.*

investment advice providers is the best way to bring securities laws into alignment with existing investor expectations and provide meaningful investor protection.