19-2886-AG(L)

19-2893-ag(CON)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

XY PLANNING NETWORK, LLC, FORD FINANCIAL SOLUTIONS, LLC,
STATE OF NEW YORK, STATE OF CALIFORNIA STATE OF CONNECTICUT,
STATE OF DELAWARE, STATE OF MAINE, DISTRICT OF COLUMBIA,
STATE OF NEW MEXICO and STATE OF OREGON,

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
WALTER CLAYTON, IN HIS OFFICAL CAPACITY AS CHAIRMAN OF THE
UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondents.

On Appeal from the Securities & Exchange Commission

BRIEF FOR *AMICUS CURIAE* THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF PETITIONERS

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UNITED STATES COURT OF APPEALS
for the
SECOND CIRCUIT

XY Planning Network, LLC, Ford Financial Solutions, LLC, State of New York, State of California, State of Connecticut, State of Delaware, State of Maine, District of Columbia, State of New Mexico and State of Oregon, Petitioners, v. United States Securities and Exchange Commission, and Walter Clayton, in his official capacity as Chairman of the United States Securities and Exchange Commission, Respondents.	Docket No: 19-2886

CORPORATE DISCLOSURE STATEMENT

Certificate required by Fed. R. App. P. 26.1(a):

I, the undersigned, counsel of record for the Public Investors Arbitration Bar Association certify that to the best of my knowledge and belief, *amicus curiae* Public Investors Arbitration Bar Association is a non-profit association. It has no parent corporation, and no publicly held corporation owns 10% or more of its stock.

These representations are made in order that judges of this Court may determine the need for recusal.

Dated: January 3, 2020

Respectfully submitted,
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INTRODUCTION AND INTEREST OF *AMICUS CURIAE* [1]

The Public Investors Arbitration Bar Association ("PIABA") is an international bar association whose members represent investors in disputes with the securities industry. Currently, PIABA has approximately 400 members from 44 states, Puerto Rico, and Japan. Established in 1990, the mission of PIABA is to promote fairness in the rules governing dispute resolution for investor claims against securities and commodities brokerage firms, registered investment advisory firms, and their associated representatives. PIABA also works toward creating, improving, and enforcing statutes, rules, regulations, case law, and policies designed to promote investor rights and to prevent misconduct by those who sell investments to the public.

PIABA accomplishes its mission partly through active involvement in the administrative rule-making process. PIABA members have a strong interest in the standards of conduct that govern those who advise investors, and share a great concern for any proposed changes to or interpretation of legal standards that may lessen investor protections from potential financial harm. PIABA members represent investors who have received poor investment advice from investment

[1] Disclosure Statement pursuant to F.R.A.P. 29(a)(4)(E): No party's counsel authored the brief in whole or in part; no party and no party's counsel contributed money that was intended to fund preparing or submitting the brief; and no person—other than the amicus curiae, its members, or its counsel—contributed money that was intended to fund preparing or submitting the brief.

advisers, securities brokers, and other financial professionals. Often, the poor advice arises because of conflicts between the financial professional's interests and the investor's interests. The conflict generally arises when the financial professional is financially incentivized to recommend one investment product or strategy over another, where the former is more financially lucrative to the financial professional (and to the detriment of the investor who carries the burden of additional costs or fees associated with that recommendation). Over time, such inappropriate recommendations, which are often accompanied by higher expenses, compound into significant lost investment returns for the investor. Believing that their financial professional would never make such a recommendation, in part because of the confusing regulatory systems, titles, and misleading advertising described here, public investors are at risk of potentially devastating results. PIABA members have seen firsthand the harm that has resulted from a regulatory system that falls short of protecting the public. PIABA gives a voice in the rule-making process to those investors and advocates for their protection.

This case involves a rule package which the Securities and Exchange Commission (the "Commission") adopted governing investment advice. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (June 5, 2019) (to be codified at 17 C.F.R. §§ 240.15*l*1, 240.17a-3, and 240.17a-4); Form CRS Relationship Summary; Amendments to Form ADV, 84

Fed. Reg. 33492 (June 5, 2019) (to be codified at 17 C.F.R. §§ 200.800, 240.17a-3, 240.17a-4, 240.17a-14, 249.641, 275.203-1, 275.204-1, 275.204-2, 275.204-5, 279.1); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669 (June 5, 2019); and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33681 (June 5, 2019).

The Petitioners in this case (hereinafter the "Petitioners") contest the Commission's rulemaking on a number of grounds. As a bar association whose members represent investors who have been wronged and often lost their life savings because of securities industry misconduct, PIABA can speak to whether the securities laws have protected investors in line with investor expectations. In furtherance of this, PIABA will provide background as to the current statutory and regulatory structure, to provide context for understanding the Commission's rulemaking. As discussed by the Petitioners' briefs, the Commission's rulemaking does not adequately address investor confusion about the standards governing investment advice, or protect investors from the harm that has resulted from that confusion. PIABA strongly supports the Petitioners' request that the Commission's rulemaking be set aside.

ARGUMENT

The federal laws governing investment advice have been enacted in a piecemeal fashion over the past eight decades. Congress passed each statute to serve a particular purpose, and various administrative agencies have authority to effectuate each statute's stated purposes. Collectively, this piecemeal legislative approach has caused the same conduct—giving investment advice—to be regulated in significantly different ways. Unsurprisingly, the current regulatory structure often baffles investors.

I. Laws Governing the Securities Industry and Investment Advice

A. Federal and State Regulation of Investment Advice

Widespread investments in securities are a relatively recent phenomena in United States history. The U.S. government began offering bonds during World War I, which sparked public interest in securities. *See* Christine Lazaro, *The Future of Financial Advice: Eliminating the False Distinction Between Brokers and Investment Advisers*, 87 St. John's L. Rev. 381, 386 (2013). By 1934, it was estimated that more than 10 million men and women owned stocks and bonds. *See* H.R. Rep. No. 73-1383, 3 (1934). Following the stock market crash in 1929, Congress turned its attention to the oversight of the securities industry and laid the foundation for the legislative and regulatory framework governing the securities industry.

Congress adopted the first of the federal statutes governing the securities industry, the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified at 15 U.S.C. § 77a, *et seq.* (2012)), in the midst of the Great Depression. This statute "require[s] that investors receive financial and other significant information concerning securities being offered for public sale." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n., https://www.sec.gov/about/laws.shtml.

A year later, Congress adopted the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified at 15 U.S.C. § 78a, *et seq.* (2018)) (the "1934 Act"). The 1934 Act was intended to address three problems: (1) "the excessive use of credit for speculation;" (2) "the unfair practices employed in speculation;" and (3) "the secrecy surrounding the financial condition of corporations which invite the public to purchase their securities." S. Rep. No. 73-792, 5 (1934).

Congress created the Securities and Exchange Commission (the "Commission") with the 1934 Act, and empowered it "to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (SROs)." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n, *supra*. The 1934 Act also gave the

Commission oversight responsibility for brokers and brokerage firms. *See* Lazaro, 87 St. John's L. Rev. 390.

The 1934 Act contains a broad antifraud provision:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange[]
> . . . .
> (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Manipulative and deceptive devices, 15 U.S.C. § 78j (2018). The Commission is given the responsibility to develop rules and regulations defining the conduct it deems unacceptable. *See* Lazaro, 87 St. John's L. Rev. 390. In 1948, the Commission adopted Rule 10b-5, which broadly prohibits fraud in connection with the purchase or sale of securities. *See* Employment of manipulative and deceptive devices, 17 C.F.R. §240.10b-5 (2019).

Congress next turned its attention to investment counselors. In 1939, the Commission submitted a report to Congress which examined investment counselor firms and investment counselors. *See Inv. Trusts and Inv. Cos.: Report of the Sec. and Exch. Comm'n Pursuant to Section 30 of the Public Utility Holding Co. Act of 1935* ("*Commission Report*"), Sec. & Exch. Comm'n (1939). Prior to 1919, there were very few investment counselors. *See* Lazaro, 87 St. John's L. Rev. 391.

Once investment in securities became more widespread, investors turned to investment counselors for advice. *See id.* While investors sought advice from investment counselors, "there was no one to whom [an investor] could turn and retain professionally the way he would retain a lawyer on a technical problem where he was up against technical men on the other side who knew more than he did." *Commission Report*, 4-5. Investment counselors varied widely in their expertise and standards of care. *See* Lazaro, 87 St. John's L. Rev. 391.

Representatives of investment counselors recognized that their function was the "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments" and they could not do this "unless all conflicts of interest between the investment counsel and the client were removed." *Commission Report*, 28. The *Commission Report* demonstrated that there was a regulatory gap that needed to be addressed. Following the issuance of this report, Congress adopted the Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (1940) (codified at 15 U.S.C. § 80b-1, *et seq.* (2018)) (the "Advisers Act").

The Advisers Act defines an "investment adviser" as:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

Definitions, 15 U.S.C. § 80b-2(a)(11) (2018). Like the 1934 Act, the Advisers Act also prohibits fraud and deceptive practices on the part of investment advisers. *See* Prohibited transactions by investment advisers, 15 U.S.C. § 80b-6 (2018). However, the Advisers Act is *broader* in terms of the actions that are prohibited, making it unlawful for an investment adviser:

> **(1)** to employ any device, scheme, or artifice to defraud any client or prospective client;
> **(2)** to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
> **(3)** acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or
> **(4)** to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Id. The Commission has the authority to regulate the conduct of investment advisers pursuant to the Advisers Act. *See* Lazaro, 87 St. John's L. Rev. 394.

Explicitly exempted from the definition of "investment adviser" is "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Definitions, 15 U.S.C. § 80b-2(a)(11)(C) (2018). When

Congress adopted this definition in 1940, it acted against the backdrop of statutes then in effect at the state levels. Many state statutes covering investment counselors exempted brokers because any investment advice furnished by them was incidental to other functions they performed. *See Memorandum submitted by the Securities and Exchange Commission entitled "Statutory Regulation of Investment Counselors, by research department, Illinois Legislative Council,"* Investment Company Act of 1940 and Investment Act of 1940, P.L. No. 768, 1005, 1007 (1940). Thus, in the Advisers Act, Congress adopted similar language, conditioning the exemption on the provision of advice being incidental to the conduct of the broker's business, and the broker not receiving any special compensation for the advice. It was clear, however, that a broker may be subject to the Advisers Act if both of these conditions were not met. At the time, the Commission's General Counsel offered his opinion on the topic:

> Clause (C) of Section 202(a)(11) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause (C) which refers to 'special compensation' amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities.

Opinion of General Counsel Relating to Section 202(a)(11)(c), Investment Advisers Act Release No. 2, 1940 WL 975 (Oct. 28, 1940). As a result of the 1934 Act and the Investment Advisers Act, the Commission is charged with regulating the conduct and standards for both securities brokers and investment advisers.

B. Standards of Conduct Applicable to the Provision of Investment Advice

There are a number of statutes and regulations governing investment advice; accordingly, there are a number of different standards of conduct applicable to investment advice depending on who is giving the advice and what type of advice is being given.

Both the 1934 Act and the Advisers Act contain antifraud provisions, which are the primary source for the standards of conduct applicable to securities brokers and investment advisers. The Supreme Court examined both the 1934 Act and the Advisers Act to determine the standard of care associated with each Act. In doing so, the Supreme Court focused on the level of intent necessary to violate each Act's antifraud provision. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

In examining the Advisers Act, the Court concluded the standard of care for investment advisers was fiduciary in nature. *See Capital Gains*, 375 U.S. at 191. Justice Goldberg, writing for the majority, stated,

> And the Committee Reports indicate a desire to preserve 'the personalized character of the services of investment advisers,' and to eliminate conflicts of interest between the investment adviser and the clients as safeguards both to 'unsophisticated investors' and to 'bona fide investment counsel.' The Investment Advisers Act of 1940 thus 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 as investment adviser—consciously or unconsciously—to render advice which was not disinterested. It would defeat the manifest purpose of the Investment Advisers Act of 1940 for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to clients.

Id. at 191–92.

As a result of the Supreme Court's decision in *Capital Gains*, the standard of care for violation of the Advisers Act does not require proving the element of intent to commit a fraud or deceit for a violation of the antifraud provision of the Advisers Act.

In contrast, the Supreme Court determined that the antifraud section of the 1934 Act was intended to cover behavior that involved some element of scienter. *See Ernst & Ernst*, 425 U.S. at 201. As explained by the Supreme Court, "Section 10(b) makes unlawful the use or employment of 'any manipulative or deceptive device or contrivance' in contravention of Commission rules. The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that [section] 10(b) was intended to proscribe knowing or intentional conduct." *Id.* at 197. The Supreme Court was "unwilling to extend the

scope of the statute to negligent conduct." *Id.* at 214. Accordingly, the antifraud section of the 1934 Act is not viewed as creating a fiduciary standard.

Although the term fiduciary is not found within the Advisors Act and is therefore undefined as it relates specifically to investment advisers, the Supreme Court held that an investment adviser's fiduciary standard includes "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' . . . clients." *Capital Gains*, 375 U.S. at 194. Additionally, the Commission determined the investment adviser's fiduciary duty imposes continuing duties of loyalty and care. *See* SEC Staff, *Study on Inv. Advisers and Broker-Dealers*, p. 22 (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf. The duty of loyalty requires investment advisers to act in their clients' best interests and disclose all conflicts of interest. *See id.* The duty of care requires investment advisers to provide suitable investment advice after investigating a customer's financial situation and investment objectives. *See id.* at 27-28.

Securities brokers, in contrast to investment advisers, are not held to the fiduciary standard, and instead, their conduct is generally regulated under the rules of their SRO, the Financial Industry Regulatory Authority ("FINRA").[2] FINRA

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[2] FINRA is a self-regulatory organization and is responsible for regulating brokerage firms and securities brokers. *See What We Do*, Fin. Indus. Regulatory Auth., http://www.finra.org/about/what-we-do.

Rule 2111 (the "Suitability Rule") governs the recommendations a securities broker or brokerage firm makes to an investor. The Suitability Rule provides in relevant part:

> A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.

FINRA Manual, Fin. Indus. Regulatory Auth., Rule 2111(b).[3]

The Suitability Rule provides the foundation for the duties and obligations of securities brokers selling investments to their clients and is interpreted as a lesser standard than the fiduciary standard applied to investment advisers.

Layered upon the federal regulatory scheme is state regulation and state common law, which also govern securities brokers' conduct. A number of states impose a fiduciary duty upon brokers as a matter of common law. In some states, the broker is a fiduciary simply by virtue of being a broker; in other states, a broker may be deemed a fiduciary depending upon the relationship between the broker and the customer.[4] Nevada alone imposes a fiduciary duty by statute. *See*

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[3] A "member" is a brokerage firm and an "associated person" is a securities broker.

[4] *See, e.g., Glisson v. Freeman*, 532 S.E.2d 442, 449 (Ga. Ct. App. 2000) (A "stockbroker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith."); *Thropp v. Bache Halsey Stuart Shields, Inc.*, 650 F.2d 817, 819 (6th Cir. 1981) ("As a fiduciary, a broker stands in a special relationship to a client and owes him a duty to use reasonable care and to act in good faith."); *Dinsmore v. Piper Jaffray, Inc.*, 593 N.W.2d 41, 46 (S.D. 1999) ("Investors, as a rule, employ securities brokers to perform specialized

Financial Planners, N.V. Rev. Stat. § 628A, *et seq*. (2019). Thus, brokers are subject to the FINRA Suitability Rule and may also be subject to a fiduciary standard depending on the state in which they are doing business and/or the nature of their relationship with their customer. However, the duties vary widely across the country.

C. The Commission Attempts to Further Exempt Brokers from the Advisers Act

When the Advisers Act was drafted, Congress explicitly exempted brokers from the definition, so long as any advice given by the broker is "solely incidental" to the brokerage services offered and the broker receives no "special compensation." Definitions, 15 U.S.C. § 80b-2(a)(11)(C) (2018).

Over time, brokers expanded the services and fee structures they offered their clients to include fee-based programs in addition to the traditional transaction-based commissions that had dominated the brokerage industry since its inception. Through the fee-based programs, brokers offered investors "a package of brokerage services—including execution, investment advice, custodial and recordkeeping services—for a fixed fee or a fee based on the amount of assets on account with the broker-dealer." Certain Broker-Dealers Deemed Not To Be

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financial services and entrust the brokers with the authority to act for them. This repose of trust in the broker, that the broker will act in the client's best interest, is a mark of a fiduciary relationship."); *Leib v. Merrill, Lynch, Pierce, Fenner & Smith*, 461 F.Supp. 951, 952 (E.D. Mich. 1978) ("Unlike the broker who handles a nondiscretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense.").

Investment Advisers, Release No. 34-42099, Investment Advisers Act Release No. 1845, 64 Fed. Reg. 61226-01, 61228 (Nov. 10, 1999). The Commission understood that fees earned in fee-based accounts might constitute "special compensation" for advice under the Advisers Act. *See id.* at 61227. However, the Commission did not believe that these compensation arrangements should subject brokers to the Advisers Act. "While in 1940 the form of compensation a broker-dealer received may have been a reliable distinction between brokerage and advisory services, development of the new brokerage programs suggest strongly that it is no longer." *Id.* Accordingly, in 2005, the Commission adopted Rule 202(a)(11)-1(a), which exempted brokers who charged clients these fees from being considered investment advisers, and therefore being subject to the fiduciary standard, so long as the advice remained solely incidental to the brokerage services provided to the customer. *See* Certain Broker-Dealers Deemed Not To Be Investment Advisers, Release No. 34-51523, Investment Advisers Act Release No. 2376, 70 Fed. Reg. 20424-01, 20434 (Apr. 19, 2005).

The Court of Appeals for the D.C. Circuit quickly rejected the Commission's attempt to impermissibly expand the exemption for brokerage firms. *See Fin. Planning Ass'n v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (Kavanaugh, J.). The court found that in adopting Rule 202(a)(11)-1, the Commission improperly relied on its broad power to exempt "other persons." *See id.* at 487-90. As

Congress had already provided for an express exemption for brokers, the Commission could not use its "other persons" authority to create a separate exemption for them. *See id.* Following the ruling, brokers who offered fee-based accounts were required to register as investment advisers and comply with the Advisers Act.

II. Investors Do Not Understand the Difference Between Brokers and Investment Advisers

The duty a financial professional owes to an investor is not readily apparent to the investor. Although the individuals who provide advice to investors have specific titles under the respective regulatory regimes – broker or investment adviser – they rarely use those titles when dealing with the investing public. Moreover, financial professionals may use confusing advertising, conveying the impression to investors that they are trusted advisors who owe a fiduciary duty to customers, even if they are not investment advisers. To add additional confusion, some investment professionals act as both brokers and investment advisers for the same client. The existing gap in the regulations between brokers and investment advisers causes harm to investors, harm which has not been adequately addressed by the Commission's rulemaking.

A. The Use of Professional Designations by Financial Professionals

Financial professionals often use the title "financial advisor," "financial consultant," "wealth manager," or a number of other titles that may not have a

specific legal definition, and which compound public confusion. According to FINRA, these "are generic terms or job titles, and may be used by investment professionals who may not hold any specific credential." *Rules and Resources*, Fin. Indus. Regulatory Auth., https://www.finra.org/investors/pd-rules-and-resources. FINRA has created a database for investors "to decode the letters that sometimes follow a financial professional's name" and to understand the various professional designations used by financial professionals. *See Prof'l Designations*, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/professional-designations. The North American Securities Administrators Association ("NASAA") has recognized the confusion and trouble that may be caused by the use of professional designations and has adopted a model rule prohibiting the misleading use of senior and retiree designations to address concerns over particularly troubling designations. *See* Press Release, NASAA, State Sec. Regulators Announce New Model Rule on the Use of Senior Certifications and Prof'l Designations, NASAA (Apr. 1, 2008), http://www.nasaa.org/5685/.

B. Advertising by Financial Professionals

The brokerage industry's advertising, which creates the perception that the industry is acting in the best interests of its customers is as troubling as the use of confusing titles. PIABA examined several brokerage firms' websites and marketing materials and found that the firms used phrases such as "You're in good

hands"; "get a more personalized plan for achieving success"; "Our advisors are ethically obligated to act with your best interests at heart"; and "your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio." Joseph C. Peiffer & Christine Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Indus. Adver. Creates the Illusion of A Fiduciary Duty Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard*, 22 PIABA B.J. 1, 10-19 (2015); *see also* Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should be Fiduciaries*, 87 WASH. L. REV. 707, 754-58 (2012) (demonstrating that, for decades, brokers have increasingly advertised "independent, objective advice" and the "close relationship between the firm and customer by using imagery such as a broker attending a customer's family function or a broker and customer walking down the beach together."); Angela A. Hung, et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, RAND INST. FOR CIVIL JUSTICE xix (2008), available at: https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (sponsored by the U.S. Sec. and Exch. Comm.) ("[Retail investors] view financial advisors and financial consultants as being more similar to investment advisers than to brokers in terms of services and duties . . . [due to] 'we do it all' advertisements mak[ing] it difficult to discern broker-dealers from investment advisers."). Notwithstanding

brokerage firms' presentment that they were looking out for their customers and acting in their best interests, when faced with claims for wrongdoing in arbitration, the firms denounced any fiduciary duties to their customers, often claiming they were nothing more than mere order-takers. *See* Peiffer & Lazaro, 22 PIABA B.J. 10-19.

It is not surprising that investors are confused by ambiguous titles and advertising that imply that brokerage firms are looking out for their customers. Most investors think stockbrokers, insurance brokers, financial advisors and investment advisers are all held to a fiduciary standard, even though investment advisers are the only ones consistently held to such a duty. *See* Infogroup/ORC, *U.S. Investors & The Fiduciary Standard: A Nat'l Opinion Survey* (Sept. 15, 2010), https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf. More recently, a 2015 study confirmed that most retail customers think their financial advisor – regardless of which type of advisor it is – is a fiduciary. *See* Spectrem Group, *Fiduciary – Do Investors Know What It Means* (2015), http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf. The investment advice industry is well aware of the confusion. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said "investors don't understand the differences between

brokers and investment advisers." *See* fi360, *Seeking Trustworthy Advice for Individual Investors – Fin. Intermediaries Indicate Strong Support for Fiduciary Standard*, 3 (Feb. 2015), http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf.

C. Confused Relationships and the Harm to Investors

Brokers may receive different compensation depending on the product the broker recommends to an investor. *See* Benjamin P. Edwards & Christine Lazaro, *The Fragmented Regulation of Investment Advice: A Call for Harmonization*, 4 Mich. Bus. & Entrepreneurial L. Rev. 47, 67 (2014). The Commission itself has expressed concern in the past about differential compensation, and how such compensation structures may raise questions as to whether a broker is providing "objective advice, or simply maximiz[ing] commission income." Committee on Compensation Practices, U.S. Sec. and Exch. Comm'n, *Report of the Committee on Compensation Practices* 8 (1995), available at http://www.sec.gov/news/studies/bkrcomp.txt. The Commission recognized that paying higher commissions for certain types of investments or for propriety products may create a misalignment of interests. *Id.* at 12. An area of particular concern was high risk products, as these products often provide brokers with higher compensation. *Id.* at 13.

FINRA also expressed concern about broker compensation practices when it released a report on conflicts of interest, citing the need to mitigate the financial incentives to recommend one investment product over another, proprietary products versus non-proprietary products, or products of issuers with whom the firm has a revenue-sharing arrangement. *See* FINRA, *Report on Conflicts of Interest* 26-30 (Oct. 2013), available at https://www.finra.org/sites/default/files/Industry/p359971.pdf.

Adding to the confusion, as discussed above, a financial professional may also be dually-registered, as both a broker and an investment adviser representative. Following the court's decision in *Fin. Planning Ass'n v. SEC*, *supra*, many brokers registered as investment advisers so as to be able to continue offering both commission-based accounts and fee-based accounts. *See* Lazaro, 87 St. John's L. Rev. 411. In 2010 when the Commission studied the standards of conduct applicable to brokers and investment advisers, it found that approximately 88 percent of investment adviser representatives were also registered as brokers with FINRA. *See* U.S. Sec. and Exch. Comm'n, *Study on Investment Advisers and Broker-Dealers* 12 (2011), available at www.sec.gov/news/studies/2011/913studyfinal.pdf.

The U.S. Treasury Department has also expressed concern about this blurring of the lines:

> Retail investors are often confused about the differences between investment advisers and broker-dealers. Meanwhile, the distinction is no longer meaningful between a disinterested investment advisor and a broker who acts as an agent for an investor; the current laws and regulations are based on antiquated distinctions between the two types of financial professionals that date back to the early 20th century. Brokers are allowed to give "incidental advice" in the course of their business, and yet retail investors rely on a trusted relationship that is often not matched by the legal responsibility of the securities broker. In general, a broker-dealer's relationship with a customer is not legally a fiduciary relationship, while an investment adviser is legally its customer's fiduciary.
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> From the vantage point of the retail customer, however, an investment adviser and a broker-dealer providing "incidental advice" appear in all respects identical. In the retail context, the legal distinction between the two is no longer meaningful. Retail customers repose the same degree of trust in their brokers as they do in investment advisers, but the legal responsibilities of the intermediaries may not be the same.

Dep't of the Treasury, *Financial Regulatory Reform: A New Foundation* 71 (2009), available at http:// www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

The blurring of the line between a broker and investment adviser has become even more pronounced as the cost of broker services has declined. A number of brokerage firms no longer charge a fee for execution services. For example, earlier this year, Schwab and TD Ameritrade cut commissions for online stock trades to $0. *See* Alexander Osipovich & Lisa Beilfuss, *Schwab Cuts Fees on Online Stock Trades to Zero, Rattling Rivals*, Wall Street Journal (Oct. 1, 2019), available at https://www.wsj.com/articles/charles-schwab-ending-online-trading-commissions-on-u-s-listed-products-11569935983. At the time, Vanguard and

Fidelity had already eliminated the fees for many funds trading on their platforms. *See Id.* JP Morgan & Chase Co. and Bank of America's Merrill Edge product both offer some commission-free trading. *See Id.* As the cost to execute trades, the traditional service of brokerage firms, drops to zero, it seems the advice offered by brokers is no longer "solely incidental" to their brokerage services. Accordingly, brokers are receiving more "special compensation" which should subject them to the Advisers Act.

PIABA commented on the Commission's rulemaking package and provided several examples of investors who had been represented by PIABA members and who had been harmed by investment advice which was not appropriate for investors, often favoring the financial professional's interests. *See generally*, Letter from PIABA *to the U.S. Sec. and Exch. Comm'n* (Aug. 7, 2019), https://www.sec.gov/comments/s7-07-18/s70718-4182233-172533.pdf. These investors trusted their retirement funds to "financial advisors" – securities brokers, investment advisers and insurance brokers – and lost substantial portions of their retirement savings as a result of the investment advice they received – advice that was often tainted by conflicts. PIABA members have witnessed firsthand the devastating effects when investors receive poor advice, seeing retirees forced to return to work making little more than minimum wage, and even dealing with clients attempting suicide after having lost their life savings to conflicted

investment advice. *See* Joseph Peiffer, *Statement for the Record Submitted to the U.S. Dep't of Labor Employee Benefits Sec. Admin. On the Conflict of Interest Proposed Rule* (Aug. 11, 2015).

CONCLUSION

As discussed by the Petitioners' briefs, further supported by the background contained herein, the Commission's rulemaking does not adequately address investor confusion or the investor harm that has resulted from the confusion. Accordingly, PIABA believes that Commission's rulemaking should be set aside.

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Respectfully submitted,
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