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Conflicts of Interest and the Duty of Loyalty at the Securities and Exchange Commission

By Knut A. Rostad

Recently, Securities and Exchange Commission (SEC) Chair Mary Jo White said she supported the SEC moving ahead with a uniform standard for broker-dealers and investment advisers. As the Wall Street Journal reported, Chair White stated: "My own personal view is that the SEC should act … to implement uniform fiduciary" standards among brokers and other financial professionals overseen by the Securities and Exchange Commission,…"[1]

This announcement comes two years since Chair White took office on April 10, 2013, and almost six years since the Obama Administration announced its support for such a measure June 17, 2009. Then SEC Chair Mary Schapiro immediately expressed support in strong terms on June 18, 2009.[2] During this six years the SEC has heard a wide range of views—from brokerage industry lobbyists to investor advocates—as to what, exactly, a uniform standard should entail. These views reflect starkly distinct visions of the very meaning of "investor protection" in the SEC's mission.[3]

The question of what a rule may entail is much discussed in the securities industry. There is increasing clarity in the SEC's view of conflicts of interest, a central issue that defines the duty of loyalty. SEC decisions, statements from Staff and Commissioners and statements from former SEC Staff and Commissioners depict a crystallizing view that conflicts of interest have become "normal" and acceptable. Conflicts are no longer viewed as inherently inconsistent with objective advice or clearly harmful to investors or incontrovertibly unacceptable. The "new normal" is that conflicts are "OK."

Background – Prior Views of Conflicts of Interest

The Obama administration announced its support in June 2009 to require brokers rendering advice to be held to the fiduciary standard. Since then, the brokerage industry has pursued a multipronged strategy comprising varying arguments to defeat such a rule—while at the same time also claiming to support the fiduciary requirement to put the interests of brokerage customers first.

Until recently, well-established views on conflicts of interests were clear. While there is no question that advisers are permitted to either eliminate or to disclose conflicts, there was no ambiguity which option the SEC urged advisers follow. The SEC urged that advisers avoid conflicts. The SEC Staff repeatedly advocated avoidance; that is, "As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts…"[4]; or "You should not engage in any

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activity in conflict with the interest of any client… You must eliminate or at least disclose, all conflicts of interest…"[5]

A veteran SEC Staff member (whose view does not necessarily reflect the SEC' views) expressed this view even more succinctly: "An adviser must act solely for the benefit of its client and must not place itself in a position of conflict with its client. *An exception is made*, (emphasis added) however, when the adviser makes full disclosure to its client and obtains the client's informed consent."[6]

Prior emphasis on "avoiding" as opposed to "disclosing" conflicts is clear. In 2012, Carlo V. di Florio, then Director, SEC Office of Compliance Inspections and Examinations, spoke bluntly about why conflicts of interest are so important to the SEC.[7]

> Conflicts of interest can be thought of as the viruses that threaten the organization's well-being.… These viruses come in a vast array of constantly mutating formats, and if not eliminated or neutralized, even the simplest virus is a mortal threat to the body.

These views reflected the view of conflicts in the landmark Supreme Court *Capital Gains* decision that recognized a fiduciary duty in the Investment Advisers Act of 1940. The opinion noted, "… investment advisers could not completely perform their basic function – furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client were removed."[8]

Conflicts of Interest, Disclosure and 'Best Interest' Today

Against this backdrop of an unambiguous view that conflicts are harmful and should be avoided, the brokerage industry apparently decided, among other things, to adopt an ambitious strategy. Instead of changing its practices, it sought to change the perception of conflicts, to re-brand conflicts of interest.

This means to replace conflicts' well-established view of being inherently inconsistent with objective advice, with a view that is, effectively, the opposite. A definition that positions conflicts as benign and far less important than previously believed. In this new paradigm, for example, it is not suggested that conflicts are harmful. Rather, conflicted advice is portrayed as beneficial. The brokerage industry argument that conflicted advice can be beneficial seems accepted in the SEC. The parallel Brokerage industry argument of the fairness and reasonableness of "business model neutrality" – which inherently depends on viewing conflicts as OK – seems to have taken hold. Today, conflicts are normal byproducts of providing advice that can be easily handled with a mere swipe of a "disclosure key."

Examples of this emerging new and benign definition are evident in the March 2013 Request for Information (RFI), three recent SEC decisions regarding conflicts of interest, a recent speech by Julie M. Riewe, Co-Chief, Asset Management Unit of the SEC, and comments by Robert Plaze, the former Associate Director of the SEC's Division of Investment Management.

March 2013 RFI

This re-branding is apparent in the March 2013 SEC "Request for Information."[9] While the SEC notes that its views in the RFI may not reflect the views of the SEC, they are important. They represent general acceptance of this new benign view of conflicts and effectively replace the 'best interest' requirement with a minimal disclosure requirement.[10]

Three Recent SEC Decisions

Further, in three recent SEC administrative decisions over the past year, the prominence of disclosure requirements and the irrelevance of the best interest of the client is evident.

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In Total Wealth Management the SEC stated, "Total Wealth and Cooper breached their fiduciary duties to their clients by failing to adequately disclose the material information about the revenue sharing fee arrangements and the conflicts of interest posed by these arrangements."[11] There is no mention of a failure to act in the best interest of the client.

In the Robare Group, "This matter involves an investment adviser's failure to disclose compensation it received through agreements with a registered broker-dealer and conflicts arising from that compensation."[12] There is no mention of a failure to act in the best interest of the client.

In Shelton Financial Group, an investment adviser failed to disclose compensation received through an arrangement with a broker-dealer.[13] The violation, according to the SEC, was a failure of disclosure. There is no mention of a failure to act in the best interest of the client.

"Conflicts, Conflicts, Everywhere … "

Most recently, on February 26 of this year, Julie M. Riewe, Co-Chief, Asset Management Unit of the SEC's Division of Enforcement, delivered remarks at an industry conference, "Conflicts, Conflicts, Everywhere …" In these remarks, Riewe discussed, among other things, "The AMU's overreaching concern—conflicts of interest." (Key excerpts from these remarks are noted below.)[14]

> To fulfill their obligations as fiduciaries, and to avoid enforcement action, advisers must identify, and then address - through elimination or disclosure - those conflicts …..
>
> ….. Only through complete and timely disclosure can advisers, as fiduciaries, discharge their obligation to put their clients' and investors' interests ahead of their own.

The meaning of this plainly written analysis is clear: disclosure, in and of itself, equals putting the client's interests first, ahead of the interests of advisers. That is, irrespective of the risk, the costs, or the quality of the advice and the underlying investment, or the benefits of the investment recommendation to the firm or the representative. The mere act of disclosing the conflict to the client puts the client's interests first.

Not only under this rationale does disclosure equal the client's best interests. According to Ms. Riewe it is the ONLY way to discharge a client's best interest. Riewe simply says that *only* through "complete and timely disclosure" can the duty to put their clients' interest first be discharged.

Robert Plaze on Conflicts of Interest, Clients' Best Interest and Disclosure

On the role of disclosure in addressing conflicts of interest, Robert Plaze, former SEC Deputy Director of Investment Management offered his views and about Riewe's speech. Plaze notes the following:

> Disclosure and client consent will always satisfy the adviser's duty of loyalty. Clients can consent to conflicts-not just some conflicts. It's right in Capital Gains decision, although some people tend to focus more on some of the other hyperbole in the decision. Can you ever have fraud when there has been full disclosure? Julie passed on that issue, but I think the answer is that you can have fraud if the SEC or Court does not infer client consent from the disclosure. Let me give you an example. In the middle of a brochure or other client communication, the adviser explains that he will use your money to pay his mortgage if he is short some month. I think a court would not infer consent. Sometimes advisers have clients who ask them to do the darnedest things, such as to have all of their trades executed by a brother-in-law at a small brokerage firm. I usually advise that in such cases the adviser

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provide separate written disclosure about the conflict and obtain the client's written consent-just so that there isn't a question of whether the consent was effective later on if the relationship turns south.

When I give a talk on these matters, I usually pose the following rhetorical question: What is the difference between "2 and 20" and theft? The answer, of course, is disclosure and consent.

But Julie was correct when she said that the SEC was unlikely to bring a case in circumstances where there was full disclosure of the conflict. I can't remember ever seeing one....

In the vast amount of cases the Commission or a court will infer consent from disclosure, such as disclosure in the brochure—even if the client hasn't read it. If they didn't do that, business itself would be impossible to conduct. So I don't blame Julie for missing that point. She is an enforcement lawyer who made clear at the conference that she was not an expert on the fine points of law.

The issue with "best interest" is who gets to decide what is in the best interest of the client? Under the Advisers Act we presume that a client who has consented has determined that the arrangement or conflict (together with any remediation offered) is in his best interest or he wouldn't have consented. The client who instructs the adviser to use his brother-in-law has perhaps decided that it is in his best interest to do that. Who gets to overrule that judgment? I would never pay 2 and 20 for investment advice because I don't believe it is in my interest to do so, but who am I to quibble with the guy who believes it is in his best interest. There are plenty of people out there who believe that active management is foolish and not in the best interest of the client. I might agree with them, but where would that take me if I were anointed to decide the question.

In some ways the "consent" prong of the test addresses what I think your concern is. So that consent will be inferred, the disclosure has to be sufficiently robust to give a client the tools to understand what is in his best interest. That's why Part 2 of Form ADV now requires disclosure about the implications of disclosed conflicts. I wouldn't want to create a regulatory structure where clients are disabled from intelligently agreeing to arrangements or conflicts that I personally would refuse to consent. I would, for example, never agree to pay for advice from an adviser who was receiving sales compensation. But I wouldn't want to preclude other persons from entering into those arrangements with an adviser.

A lot of trust law has developed in situations where the beneficiaries of the trust are for one reason or another incapable of giving consent. In those cases a court will substitute its judgment as to whether the trustee acted in the best interest of the client. The Advisers Act involves clients who are in most cases fully capable of providing consent. Failure to recognize that would send the SEC down a road of substituting its (or its staff's) judgments about best interest for the client's.

....a conflict...so severe and so contrary to the interest of the client can and should overcome the presumption that the client has consented to it absent evidence to the contrary. But in my view, as a general matter, the law assumes and should infer consent from disclosure.

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> Also, you would have to deal with questions about the role of the advisory contract. What if the client specifically contracted for the arrangement that you might conclude was not in his or her best interest? It can't turn on who proposed the contractual provision.[15]

Plaze plainly affirms the importance of the evolving principle regarding the role of disclosure. It is that disclosure and (inferred) consent, in and of itself, and irrespective of the risk, the costs, or the quality of the underlying investment, or irrespective of the benefits of the investment recommendation to the firm or the adviser, means the client's interests are put first.

Conflicts of Interest, Disclosure and 'Best Interest' Today – Harmonization of the Standards Taking Hold

The significance of this new benign definition of conflicts of interest taking hold at the SEC is evident in other ways. With the sharply negative stigma of conflicts of interest set aside, the merger of the fiduciary and suitability standards is relatively easy. It becomes far easier to apply sales suitability principles to investment advisers. It is not surprising, then, that commentary reflects the view that the harmonization of the fiduciary and suitability standards is, effectively, already underway within the SEC. Accordingly, today there is either minimal or no material difference between the standards governing brokers-dealers and investment advisers in the view of the SEC.

SEC Chair White

In his March 21 Wall Street Journal column,[16] Jason Zweig, commenting on Chair White's announcement noted,

> As Ms White said this week, "getting the balance right [between the different interests] is essential" because "if what we succeed in doing is, in effect, depriving investors of reliable, reasonably priced advice, obviously we have failed."

Elsewhere in her remarks Chair White said simply, "You have to think long and hard before you regulate differently, essentially identical conduct. "

Chair White seems to state there is no difference, or at least no material difference, between investment advisers that exist (and typically are contractually obligated) to render objective advice to their principals (that is, their clients) and broker dealers which, in the context of primary offerings, exist and are compensated and contractually obligated to distribute securities.

Chair White's expression is not new. It builds on the views of former SEC Chair Elisse Walter. Interestingly, it also sharply differs from prior articulations of SEC Staff regarding the differences between investment advisers and broker-dealers and the applicable standards of conduct.[17]

Further, in a prepared statement before the Consumer Federation of America, Chair White stated:

> Investment advisers are fiduciaries to their clients, and, as such, generally must put their clients interests above their own and avoid, or disclose, any conflicts of interest when providing investment advice.[18]

This qualifying expression of the breadth of fiduciary duties narrows their reach by injecting the word "generally" and the phrase "when providing investment advice."

David Blass, Former Chief Counsel, SEC Division of Trading and Markets

On April 23, 2014, Former Chief Counsel of the Division of Trading and Markets, David Blass, in Compliance Intelligence, stated: "I don't think that the adviser fiduciary duty is higher than suitability." According to Mr. Blass, the Division of Trading and Markets is helping to lead the fiduciary duty discussion within the SEC.

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Two Former SEC Regulators Minimize "Suitability" and "Fiduciary" Differences

Two former SEC regulators, Troy Paredes, former Commissioner, and Robert Plaze, at a September 16, 2014, "Fiduciary Summit" organized by TD Ameritrade characterized their views of the small difference between suitability rules and potential uniform rules under the Dodd Frank Wall Street Reform and Consumer Protection Act, by noting that only "2-3%" of enforcement cases turn on the difference between the two standards.

Discussion

SEC Chair Mary Jo White's statement that the SEC should proceed with rule-making on a uniform fiduciary standard focuses attention on what such a rule may entail. Recent actions and statements by current and former SEC officials—including the SEC Chair herself – are germane. They depict in bold strokes clear principles defining the duty of loyalty consistent with the new and benign view of conflicts of interest.

There is little ambiguity or uncertainty. Disclosure, in and of itself puts clients' interests first, ahead of the interests of the firm providing the advice. This means, irrespective of the risks, the costs, or the quality of the underlying investment, or any benefits of the investment recommendation conferred to the firm providing the advice, the mere act of disclosing the conflict of interest to clients puts the clients' interests first. Further, disclosure is the ONLY way to discharge a client's best interest. As Riewe states, *only* though "complete and timely disclosure" can the duty to put their clients' interest first be discharged.

The SEC and COI

Plaze explains and defends this view and his analysis is important. First, he says it's supported in the Capital Gains Research Bureau decision and that courts and the SEC "will infer consent from disclosure, such as disclosure in the brochure – even if the client hasn't read it. If they didn't do that, business itself would be impossible to conduct."

Plaze also discusses, broadly speaking, the role of best interest. "Under the Advisers Act we presume that a client who has consented has determined that the arrangement or conflict . . . . is in his best interest or he wouldn't have consented." He also adds, in contrast to trust law, "The Advisers Act involves clients who are in most cases fully capable of providing consent. Failure to recognize that would send the SEC down a road of substituting its (or its Staff's) judgments about best interest for the client's."

Then Plaze adds an important point. He writes, "So that consent will be inferred, the disclosure has to be sufficiently robust to give a client the tools to understand what is in his best interest. That's why Part 2 of Form ADV now requires disclosure about the implications of disclosed conflicts. I wouldn't want to create a regulatory structure where clients are disabled from intelligently agreeing to arrangements or conflicts that I personally would refuse to consent."

So, the SEC judges whether a client understands or may understand the implications of a conflict as described in a disclosure, while the SEC does not generally judge whether a recommendation is in the client's best interest, because clients are "capable of providing consent."

In sum, the new and benign view of conflicts of interest reduces fiduciary duties of loyalty to a contractual relationship between parties where the duty of loyalty is satisfied by mere disclosure and there is no consideration of whether the advice provided is actually in the client's "best interest."

Conclusion

This new and benign view of conflicts of interest and the corollary diminished role of the duty of loyalty "best interest" principle is fundamentally at odds with established and longstanding jurisprudence.[19] It should be recognized for the fundamental departure from the duty of loyalty that it represents.

That this view has so clearly taken hold at the SEC—on the heels of the financial crisis—should

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be ample cause for reconsidering whether an SEC uniform standard rule for broker dealers and investment advisers at the present time is truly likely to be in investors' best interest.

Knut A. Rostad is president of the Institute for the Fiduciary Standard. The Institute is a non profit that exists to advance the fiduciary standard through research, education and advocacy. For more information *see www.thefiduciary institute.org*.

NOTES

1 *http://www.wsj.com/articles/sec-head-seeks-uniformity-in-fiduciary-duties-among-brokers-advisers-1426607955.*

2 In a speech before the New York Financial Writers Association Annual Awards Dinner, Chairman Schapiro said, in part:

> When assessing these financial service providers, there is a commonality of names in certain cases and an apparent commonality of function and services provided. However, the types of financial service providers I just mentioned are subject to very different regulatory regimes. And the standards of conduct and legal duties owed to investors under those regimes are not consistent.
>
> I believe that, when investors receive similar services from similar financial service providers, they should be subject to the same standard of conduct regardless of the label applied to that financial service provider. I therefore believe that all financial service providers that provide personalized investment advice about securities should owe a fiduciary duty to their customers or clients.
>
> The fiduciary duty means that the financial service provider must at all times act in the best interest of customers or clients. In addition, a fiduciary must avoid conflicts of interest that impair its capacity to act for the benefit of its customers or clients. And if such conflicts cannot be avoided, a fiduciary must provide full and fair disclosure of the conflicts and obtain informed consent to the conflict.
>
> A fiduciary owes its customers and clients more than mere honesty and good faith alone. A fiduciary must put its clients and customers interests before its own, absent disclosure of, and consent to, conflicts of interest.

3 The wide range of views are illustrated in advocacy by the Securities Industry and Financial Markets Association (SIFMA) on the one hand (July 2011 letter on "Framework" for Uniform Standard) (*http://www.sifma.org/issues/item.aspx?id=8589934675*) and, in contrast, advocacy led by Consumer Federation of America (*http://www.consumerfed.org/pdfs/SIFMA-FrameworkResponse3-29-12.pdf*).

4 Form ADV, Part 2, General Instructions, p.1.

5 Information for Newly-Registered Investment Advisers, "Investment Advisers are Fiduciaries."

6 Robert E. Plaze, *The Regulation of Investment Advisers*, Updated to November 22, 2006.

7 *http://www.sec.gov/News/Speech/Detail/Speech/1365171491600#.VRBoKI4sq6U.*

8 SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963).

9 Available at *http://www.sec.gov/rules/other/2013/34-69013.pdf.*

10 From the Institute SEC comment letter, dated July 5, 2013, available at *http://www.sec.gov/comments/4-606/4606-3115.pdf.*

Assumptions Regarding the Uniform Fiduciary Standard [UFS] and the Duty of Loyalty

The RFI provides assumptions regarding the uniform fiduciary standard and the duty of loyalty. (As noted above, the RFI states these assumptions may not represent the views of the SEC.) The RFI picture of fiduciary duties is far more restricted and far less

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stringent than the fiduciary duties required by the Investment Advisers Act of 1940.

1. Sharply restricts what is fiduciary advice; creates new ambiguity about the difference between fiduciary advice and sales communications. Written or oral communications that are clearly "fiduciary advice" are narrowly defined. 'Facts and circumstances' exploration will be necessary to parse language and review materials to draw the line between fiduciary and nonfiduciary communications. Thus, new uncertainty and ambiguity is created that is likely to confuse investors.
2. Allows fiduciary duties be waived. Fiduciary duties may be waived through contract provisions, marketing materials or disclosure, disclosure that does not require informed consent, to ensure the client is aware when duties are waived.
3. Suggests disclosure best addresses conflicts, omits noting disclosure alone is insufficient. Stressing disclosing conflicts at the exclusion of avoiding conflicts may be interpreted to suggest disclosure is the best remedy. This interpretation would be false. Further, the failure to affirm that irrespective of the disclosure the recommendation must remain in the best interest of the client, implies disclosure alone is sufficient.
4. Weakens disclosure requirements; omits mention of "informed consent"

   It allows more casual disclosure and oral disclosure (disclosure that is more "efficient" for the firm to deliver) while, not requiring either "client consent" or "informed client consent" of material conflicts of interest (disclosure more effective for the client).
5. Rebrands conflicts. Conflicts are essentially rebranded. There is no mention of any harm associated with conflicts. It questions whether principal trading is always a conflict. It omits any mention of associated benefits of avoiding conflicts, and omits urging broker dealers and investment advisers to avoid conflicts. By these omissions, conflicts are implied to be benign.
6. Redefines loyalty. By minimizing the harm of conflicts, and stressing disclosure, it essentially urges that the duty of loyalty be redefined. Loyalty today means, essentially, "do the right thing." In this discussion it means "disclose doing the wrong thing."

Individually, each of these assumptions undermines the stringency of the UFS as compared to the Advisers Act. Together, these assumptions represent a profound departure from the Advisers Act. If adopted in rulemaking, fiduciary duties would be effectively removed for brokers and advisers giving investment advice to retail investors. The issue of whether such a uniform standard is consistent with the Dodd Frank requirement that the uniform standard be "no less stringent" than the Advisers Act is clear. It is not.

[11] *In the Matter of Total Wealth Management, Inc.* (April 15, 2014), available at *https://www.sec.gov/litigation/admin/2014/33-9575.pdf.*

[12] *In the Matter of the Robare Group, Ltd* (September 2, 2014), available at *http://www.sec.gov/litigation/admin/2014/34-72950.pdf.*

[13] *In the Matter of Shelton Financial Group*, *Inc.* (January 15, 2015), available at *https://www.sec.gov/litigation/admin/2015/ia-3993.pdf.*

[14] Key parts of Riewe's remarks are noted here. The entire speech is available at: *http://www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html#.VRREm44sq6U.*

> To fulfill their obligations as fiduciaries, and to avoid enforcement action, advisers must identify, and then address - through elimination or disclosure - those conflicts.....
>
> Does the firm receive compensation from any third parties for recommending investments or using certain service providers? Does it engage in proprietary trading or investing? If so, has the firm disclosed its potential biases and that its investment advice could

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be tainted by compensation received from any third parties or from proprietary investing?

For each conflict identified, as a threshold matter, can the conflict be eliminated? If not, why not? If the adviser cannot, or chooses not to, eliminate the conflict, has the firm mitigated the conflict and disclosed it? … As to mitigation, are the firm's policies and procedures reasonably designed to address the conflicts the firm has identified, and are they properly implemented?

... to ensure that all conflicts are disclosed, and disclosed in a manner that allows clients or investors to understand the conflict, its magnitude, and the particular risk it presents? Does the firm review those documents regularly to ensure that new or emerging conflicts are disclosed in a timely way?

..... Only through complete and timely disclosure can advisers, as fiduciaries, discharge their obligation to put their clients' and investors' interests ahead of their own."

15 Text of emails from Plaze to author, March 2015.

16 Jason Zweig, "Adviser Duties: While Regulators Fiddle, Don't Get Burned," *The Wall Street Journal*, March 20, 2015, available at *http://blogs.wsj.com/moneybeat/2015/03/20/while-regulators-fiddle-avoid-getting-burned/*.

17 Then Commissioner Walter, at the Mutual Fund Directors Forum Ninth Annual Policy Conference on May 5, 2009, set out her views on the regulation of broker-dealers and investment advisers in detail; available at *http://www.sec.gov/news/speech/2009/spch050509ebw.htm*. Among her comments was "a fundamental principle" she said "should guide any attempt to address the blurring of the lines between broker-dealers and investment advisers."

I believe that regulation of a financial professional should depend on what she does, not what she calls herself or how she is paid. As a corollary, I also believe strongly that retail investors should not bear the burden of understanding distinctions between financial professionals that have become increasingly less relevant over the years. These opaque distinctions frequently lead to investor confusion and arguments about definitions that simply should not matter. This reasoning, I believe, leads to the fundamental principle that should guide our review of how to regulate financial professionals for the protection of the investing public: Investors should receive the same level of protection when they purchase comparable products and services, regardless of the financial professional involved.

Further in her remarks, Walter reiterates, in yet stronger terms, the idea that the divergent roles, legal obligations and compensation methods plays no role in her thinking, and, a disclosure to highlight these differences she said did not "completely understand."

One possibility would be for the Commission to mandate enhanced disclosure of the duties and obligations of broker-dealers and investment advisers to give an investor more information to inform his decision to hire a financial professional. The Commission did just this in its 2005 rulemaking, when it required broker-dealers to include the following prominent statement in all contracts and agreements for fee-based brokerage accounts:

Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time.

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Although disclosure generally serves a critical purpose and is a central form of regulation under the federal securities laws, it has its limitations. I have been a securities regulator for over 30 years, and I have to confess that I do not completely understand the disclosure I just quoted.

Does it suggest that a brokerage firm does not have to do what is right for its customer? I hope not (and that was certainly not the Commission's intent). Are the interests of any financial professional and an investor ever exactly the same? They may be generally aligned but they will never be the same, which is the rationale for requiring the disclosure of material conflicts of interest. And, in addition to questioning fee-based brokerage, shouldn't investors also be encouraged to ask whether the compensation of investment advisers and commission-based broker-dealers varies by product and over time? I would think so. If I am this confused, can we possibly expect small investors to understand this statement or financial professionals to explain it?

Yet, in the 2011 "Study on Investment Advisers and Broker-Dealers" the SEC Staff expresses a very different view, "The staff believes that these differences (between investment advisers and broker-dealers) in the standard of conduct are significant and are not well understood by retail investors, as the RAND report and many commenters observed. The staff believes that investors generally expect that an investment professional is acting in their best interest and that they should not have to parse the title on a business card or other information to assess whether the professional has their best interests at heart." at page 107.

18 Available at *http://www.sec.gov/News/Speech/Detail/Speech/1370541226174.*

19 For a summary discussion of the duty of loyalty and conflicts of interest, *see* Ron A. Rhoades comment letter, available at *http://www.dol.gov/ebsa/pdf/1210-AB32-PH029.pdf,* especially Rule .32 "Reasonable Avoidance of Conflicts of Interest," and Rule, 3.3 "Disclosure of Material Facts, and Proper Management of Non-avoided Conflicts of Interest," pp.67-87.

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