INSTITUTE FOR THE FIDUCIARY STANDARD

Reg BI Exacerbates Consumer Confusion, Founded Upon a Misrepresentastion

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The prospect before me explained her reason for seeing me. She related that, after reading an article in a consumer financial publication about ensuring fiduciary advice was received, she had asked her current financial consultant if he was a fiduciary. He had replied, "I am legally bound to act in your 'best interests,'" and he provided his firm's "Best Interest Disclosure Statement." On page 5 he had highlighted the statement, "When we make a recommendation to you, it must be in your best interest at the time it is made in light of, among other things, your Investment Profile." Unlike many individual investors, who would likely be satisfied with such an answer, the astute consumer before me suspected something was up, for after spending an hour perusing the 12-page document she could not find any mention of the word fiduciary.

I explained to the prospective client that the broker was not a fiduciary, and how "Reg BI" led to this "Great Deception." I then examined the account statements from her broker, and found that the client had been placed in an extraordinarily expensive variable annuity (total fees and costs of 3.5% a year or greater), a non-publicly traded REIT that paid the brokerage firm a 10% commission (plus "marketing support payments"), and a broad array of mutual funds spread among multiple fund complexes (likely to avoid breakpoint discounts).

The prospective client was angry. So was this ole' Bear – seeing my fellow citizen treated so poorly.

There was a time when the U.S. Securities and Exchange Commission ("SEC") respected the distinctions between investment advisers (those who are in fiduciary relationships with their clients) and brokers (those who are in arms-length, sales relationships with their customers). In fact, the SEC observed, early-on, in its 1941 Annual Report:

> If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject to fiduciary duty. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States Court of Appeals for the District of Columbia in a recently decided case: '[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who

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> would deal at arm's length must stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and protector. He cannot commingle his trusteeship with merchandizing on his own account…' "[2]

And, nearly six decades ago, the Commission cautioned that broker-dealer advertising:

> may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business … Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties.[3]

Yet, in 2019, the SEC adopted "Regulation Best Interest" ("Reg BI"), which expressly permitted brokers – product salespeople, merchandizers – to use the phrase "act in your best interest" to describe the duties owed to their customer. The SEC admitted that Reg BI does not impose fiduciary duties upon brokers. In fact, Reg BI does not define the term "best interest," nor does Reg BI (as of the time of the writing of this essay) appear to be anything more than a slight upgrade to the inherently weak and vague "suitability" standard that has long governed brokers' conduct.

"Best Interests" Expresses the Fiduciary Duty of Loyalty.

The term "best interest" has long been an expression that is utilized in conjunction with the fiduciary duty of loyalty. A simple search of Westlaw, excluding cases involving ERISA, reveals over 2,000 cases that associate "best interest" phrase with the fiduciary duty of loyalty.

Yet the use of the phrase "best interests" to describe the fiduciary duty of loyalty actually goes back millennia. somewhere between 475 and 220 BC, Confucius wrote in *The Analects* a heuristic for fiduciaries: "In acting on behalf of others, have I always been loyal to their interest?"[4]

Where did the deeply flawed Regulation Best Interest arise from? To answer this question, I present its history as a three-act play, perhaps more appropriately characterized as a three-act Shakespearian tragedy.

ACT 1. FINRA Erroneously States the Brokers Recommendations Must Be "Consistent With His Customer's Best Interests."

Born from discussions within broker-dealer lobbying organizations following the Dodd Frank Act, as an attempt to stem the loss of market share by brokers to investment advisers, the foundations of Reg BI can be found in FINRA's erroneous mischaracterization of reasonable basis suitability. FINRA essentially stated in a 2011 notice that a broker's recommendations to its customers must be "consistent with" the customers' "best interest."[5] Yet, FINRA's legal reasoning, in this regard, is wholly flawed.

FINRA's unsound legal reasoning then formed the foundation of a multi-step advocacy program by broker-dealer firms and their industry associations culminating in a deeply flawed Reg BI. By way of explanation, broker-dealer firms are required to be members of a self-regulatory organization, known as the Financial Industry Regulatory

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[2] *Seventh Annual Report of the Securities and Exchange Commission*, Fiscal Year Ended June 30, 1941, at p. 158, *citing Earll v. Picken* 113 F. 2d 150 (D.C. Ct. App. 1940).

[3] 1963 SEC Study, citing various SEC Releases.

[4] Confucius; The Analects; Translated by Arthur Waley; Routledge; London and New York; 1938; 84.

[5] FINRA Regulatory Notice 11-02 at n.11.

Authority ("FINRA"). FINRA has adopted rules for its member firms and their registered representatives (hereinafter called "brokers").

Chief of these rules, with respect to brokers, was adopted early on by NASD, and is now found in FINRA Rule 2111, the "suitability rule." The suitability rule was originally designed to mitigate the duty of due care that all service providers possess. By way of explanation, with the early 20th Century rise of the concept of the duty of due care, and the commencement of actions for breach of one's duty of due care (via the negligence doctrine that saw accelerated development in the common law during the early 20th Century), broker-dealers sought a way to ensure they would not be held liable under the standard of negligence. After all, "[t]o the extent that investment transactions are about shifting risk to the investor, whether from the intermediary, an issuer, or a third party, the mere risk that a customer may lose all or part of its investment cannot, in and of itself, be sufficient justification for imposing liability on a financial intermediary."[6] This appears to be a valid view as to the duty of care that should be imposed upon a broker-dealer, and appears appropriate if the broker-dealer is only providing only trade execution services to the customer.

In essence, the suitability standard was originally designed solely to protect brokers who provided trade execution services from breaches of the duty of due care applicable to all product sellers, given the inherent risks of investing in individual securities. Yet, as broker's services expanded, the suitability standard has inappropriately been applied to broker's other services, including those services that are clearly of an advisory nature – such as the selection of investment managers (including investment advisers to pooled investment vehicles, such as mutual funds). In essence, suitability imposed few obligations upon brokers.[7]

A newer version of FINRA's suitability rule took effect on July 9, 2012. In its Regulatory Notice 11-02, FINRA discussed the suitability obligation and set forth its false claim that "it is well-settled that a 'broker's recommendations must be consistent with his customer's *best interests'* and are 'not suitable merely because the customer acquiesces in [them].'"[8] [*Emphasis* added.]

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[6] Onnig H. Dombalagianm, Investment Recommendations and the Essence of Duty, 60 Am. U.L. Rev. 1265, 1274 (2011).

[7] "Suitability's abrogation of the duty of care means that suitability lacks teeth when investment advice is provided.

- Suitability does *not* generally impose upon broker-dealers any obligation to recommend a "good" product over a "bad" one.
- Suitability does *not* impose upon brokers and their RRs a duty to recommend a less expensive product over an expensive product, even where the product's composition and risk characteristics are almost identical, and even though substantial academic research concludes that higher-cost products return less to investors than similar lower-cost products over longer periods of time.
- Suitability does *not* require brokers and their RRs to recommend products that meets most client's objectives for tax-efficient and prudent investment portfolios.
- Suitability does *not* require brokers and their RRs to avoid conflicts of interest, nor to properly management conflicts of interest that remain to keep the clients' best interests paramount at all times."

Ron Rhoades, The Unsuitability of "Suitability": SIFMA's Deceptive "Best Interests" Proposal, Scholarly Financial Planner blog post, June 15, 2015, available at: http://scholarfp.blogspot.com/2015/06/the-unsuitability-of-suitability-sifmas.html.

[8] *Id., citing Dane S. Faber*, Securities Exchange Act Release No. 49216, 2004 SEC LEXIS 277, at *23–24 (February 10, 2004); *see also Dep't of Enforcement v. Bendetsen*, No. C01020025, 2004 NASD Discip. LEXIS 13, at *12 (NAC August 9, 2004) ('[A] broker's recommendations must serve his client's best interests and the test for whether a broker's recommendations are suitable is not whether the client acquiesced in them, but whether the broker's recommendations were consistent with the client's financial situation and needs').

But FINRA was wholly incorrect in its statement. Digging deeper into a review of the cases cited by FINRA, for its "best interests" requirement edict, reveals the deception.[9] The earliest of the cases FINRA cited appears to be a 1964 SEC enforcement action, *Powell & McGowan, Inc.*[10] In that case, a broker-dealer was disciplined after the president of the firm, a broker, recommended unsuitable transactions when "the physical condition of the customer, who was then 79 years old, retired and living alone, had deteriorated to such an extent that at times it was doubtfull [sic] whether he was capable of understanding or making decisions with respect to his investments or financial matters" and where the "registrant's president, who was familiar with the customer's financial situation and aware of his age and physical condition" recommended a transaction involving a loan by the customer of investment company shares which the broker knew was losing money. The SEC stated: "*In the context of the circumstances here and the facts concerning this customer known to it and the special risks involved*, registrant had an obligation not to recommend a course of action clearly contrary to the best interests of the customer …."[11] [*Emphasis* added.] The SEC's language in its decision is therefore clearly not the imposition of a duty upon a broker to act in a customer's best interests. Rather, the decision is merely a reflection of the nature of the relationship, in that the customer – due to his physical and mental infirmities – relied upon the broker, creating a common law fiduciary-client relationship. Several other cases have imposed fiduciary status upon brokers in similar circumstances.[12]

The other cases FINRA cites all trace back, for their conclusions, to language found within a 1991 SEC decision, *John M. Reynolds*,[13] affirming an NASD (the precursor to FINRA) disciplinary action against a broker. In that action, the broker "recommended unsuitable securities transactions to a customer and engaged in excessive trading in the customer's account."[14] It was found that the customer, a church with a financially unsophisticated minister, relied upon the broker and that the broker "controlled" the account *de facto*. As stated in the SEC's decision, "Control may be established where a customer, although not granting his broker a formal power of attorney, so relies upon the broker that the latter is in a position to control the volume and frequency of transactions in the account … the record establishes that [the broker] controlled trading in the fund's account … Under these

[9] *Dane S. Faber* further cites in support of the statement found therein, "A broker's recommendations must be consistent with his customer's best interests…." to: *See, e.g., Stein*, 79 SEC Docket at 2280; *Daniel Richard Howard*, Exchange Act Rel. No. 46269 (July 26, 2002), 78 SEC Docket 427, 430; *John M. Reynolds*, 50 S.E.C. 805, 809 (1992).

[10] SEC Exchange Act Rel. No. 7302 (April 24, 1964), stating that a broker has "an obligation not to recommend a course of action clearly contrary to the best interests of the customer."

[11] *Id.*

[12] *See* comment letter of Ron Rhoades to Employee Benefits Security Administration (DOL) dated April 12, 2011, available at https://www.thefiduciaryinstitute.org/wp-content/uploads/2013/02/2011_Apr_Rhoades_Cmt_Ltr-2_Def_Fid-2.pdf: ["[E]ven though an account may be "non-discretionary" on paper, some state courts find that the registered representative may exercise *de facto* control over non-discretionary accounts. In essence, such a finding transforms the scope of the agency from a limited one to a broad one, and fiduciary duties then apply to that broadened scope of the agency."] *Id.* at p.41 *See also* A Joint Report of the SEC and the CFTC on Harmonization of Regulation (Oct. 2009), available at http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf, stating: "While the statutes and regulations do not uniformly impose fiduciary obligations on a [broker-dealer (BD)], a BD may have a fiduciary duty under certain circumstances, at times under state common law, which varies by state. Generally, BDs that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, are found to owe customers a fiduciary duty similar to that of investment advisers … State common law imposes fiduciary duties upon persons who make decisions regarding the assets of others. This law generally holds that a futures professional owes a fiduciary duty to a customer if it is offering personal financial advice." *Id.* at pp.9-10.

[13] SEC Release No. 30036 (December 4, 1991).

[14] *Id.*

circumstances, [the broker's] management of the account was clearly improper ... *As a fiduciary*, a broker is charged with making recommendations in the best interests of his customer ...."[15] [*Emphasis* added.] Again, it is clear that the imposition of the duty upon the broker, in this action, to act in the best interests of the customer, arose from the fiduciary status imposed by common law upon the broker, as a result of *de facto* control or *de facto* discretion[16] over an unsophisticated customer's account. The use in this case of the phrase "best interests" does not in any manner describe or change the duty of suitability.

FINRA's error in failing to closely examine precedent is illuminated in the well-written analysis of FINRA's poor legal reasoning authored by Brian Rubin, Amanda Giffin and Melissa Fox of Eversheds Sutherland, "INSIGHT: When Precedent Doesn't Really Stand for *That* Proposition: FINRA's Suitability Rule and the Meaning of 'Best Interest,'"[17] the other cases cited by FINRA for its pronouncement of the "best interests" obligation for brokers followed the *Reynolds* decision, "however, dropped the fiduciary qualification, but claimed to simply regurgitate precedent."[18]

In essence, by extracting words out of context, and by suggesting that brokers had a longstanding "best interest" obligation to their customers, FINRA pulled the wool over the heads of policy makers with its clearly misleading and clumsily performed legal analysis.

Thereafter FINRA touted its "best interest" obligation, and suggested it be expanded. In his May 27, 2015 address to broker-dealer firm executives gathered at the 2015 FINRA Annual Conference, FINRA Chair and CEO Richard Ketchum inquired of brokers whether "the time has come to require broker-dealers, when recommending a security or strategy to retail investors, to ensure that the recommendation is in the 'best interest' of the investor." Mr. Ketchum went on to equate FINRA's "best interest" standard (effectively pronounced in 2012) with the "fiduciary standard." Mr. Ketchum then outlined what a "best interest" standard for brokers would look like, and based it upon the provision of "consent" by the customer to conflicts of interest and "more effective disclosure" to customers by broker-dealer firms.

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[15] *Id.*

[16] "[M]any courts distinguish between non-discretionary accounts (where the broker-dealer simply carries out specific orders on behalf of the client) and discretionary accounts (where the client gives consent to the broker-dealer to purchase and sell securities without consent for each transaction). Because brokers who handle discretionary accounts for their clients have significantly more freedom to exercise judgment on behalf of the client, such brokers usually owe a fiduciary duty to the client...." Steven D. Irwin, Scott A. Lane, Carolyn W. Mendelson, WASN'T MY BROKER ALWAYS LOOKING OUT FOR MY BEST INTERESTS? THE ROAD TO BECOME A FIDUCIARY, 12 DUQ.B.L.J. 41, 47 (2009), citing *Leib v. Merrill Lynch, Pierce, Fenner & Smith*, 461 F.Supp. 951, 953 (E.D. Mich. 1978) ("Unlike the broker who handles a non-discretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense.") *Id.*

[17] Bloomberg Law, Securities Law News (Dec. 12, 2018), available at https://news.bloomberglaw.com/securities-law/insight-when-precedent-doesnt-really-stand-for-that-proposition-finras-suitability-rule-and-the-meaning-of-best-interest.

[18] *Id.*

ACT 2. SIFMA, FSI Promulgate the Proposal that Eventually Leads Reg BI.

Our tragic play continues after the U.S. Department of Labor proposed, in April 2015, a rule requiring adherence to a strict fiduciary standard, or at a minimum impose "impartial conduct standards," for nearly all brokers and others who provide advice to ERISA-covered employer-sponsored retirement plan sponsors and their participants and to IRA accounts.[19] The broker-dealer industry was alarmed.

Shortly thereafter, in June 2015, a "best interests" proposed regulation was hastily advanced by broker-dealer lobbyist organizations, SIFMA and FSI. Titled "Proposed Best Interest of the Customer Standard for Broker-Dealers," the proposal sought to apply a weak "best interest" standard – but not fiduciary duties – upon brokers.

The "best interests" standard so proposed by SIFMA only slightly expanded upon the very weak suitability standard. It deceptively denied individual investors who receive personalized investment advice from brokers, and who justifiably relied on such advice, the important protections of a bona fide fiduciary standard of conduct. In essence, the proposed "best interest" standard was but an attempt to forestall the imposition of fiduciary duties upon brokers. The arms-length, product-sales nature of broker-customer relationships remained unchanged.

Even worse, by wrapping arms-length product sales in a blanket of false assurance to consumers, SIFMA's "best interest" proposal created an illusion of protection where none exists. In 2015 I predicted that the proposal would lead to even greater[20] levels of deceptive marketing by broker-dealer firms and even greater harm to consumers than that caused by the low suitability standard.

I further questioned at the time whether SIFMA's and FSI's use of the term "best interests" in describing its proposed arises to the level of fraud and deceit that, if used by a broker-dealer firm to a customer, could constitute a violation of the securities laws' anti-fraud statutes. In essence, are the new or revised definitions that the broker-

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[19] Proposed Rule, "Definition of the Term 'Fiduciary'; Conflict of Interest Rule-Retirement Investment Advice," Employee Benefits Security Administration, U.S Department of Labor (DOL), 80 Fed.Reg. 21927-21960. The proposed rule was modified and finalized in 2016. In 2017, despite surviving five previous judicial challenges, the U.S. Court of Appeals for the 5th Circuit overturned the rule in a close 2-1 decision, after which the new leadership at the DOL refused to seek rehearing or appeal. A new "fiduciary" rule was finalized by the DOL in late 2020, which substantially weakens the fiduciary standard and its application; judicial challenges are anticipated to such rule, as well as revisions to the 2020 final rule via new rule-making or via interpretations under a new Secretary of Labor, once confirmed.

[20] As discussed in the Consumer Federation of America's January 2017 report, "Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have It Both Ways," available at https://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf, Micah Hauptman and Barbara Roper observed: "In short, in their eagerness to attract clients and increase sales, these brokers and insurers do everything they can to create the reasonable belief and expectation on the part of investors that they are providing fiduciary investment advice rather than non-fiduciary investment sales. This stands in sharp contrast to how financial trade associations have presented their business practices in legal filings … for example, … , they claimed that broker-dealer reps are just "salespeople" engaging in activity 'whose essence is sales' that is no different from other commercial sales relationships in which 'both parties understand that they are acting at arms' length.' They therefore claim that it is more appropriate that they be held to a sales-based 'suitability' standard rather than an advice-based fiduciary standard." *Id.* at pp.3-4. The paper highlighted many misleading statements:

- One firm's web page stated: ""Decisions are always made with our clients' best interests in mind."
- Another firm's web page stated in bold font, ""Trust is the cornerstone of the relationship between you, as an investor, and the [firm name]. financial professionals working for you. Your needs should always come first."
- Yet another firm, in its "Statement of Commitment" to its customers, stated: "We believe that by placing the clients' interests first, they prosper."

dealer community seeks to attach an illegitimate attempt to re-define the English language, going beyond puffery and amounting to serious breaches of trust?[21]

Act 3. SEC Proposes and Finalizes Reg BI, with FINRA Repeating of its Claim.

In 2018, the U.S. Securities and Exchange Commission ("SEC") proposed "Regulation Best Interests," which was finalized in 2019 and which became effective for compliance purposes for broker-dealers commencing June 30, 2020.[22]

The SEC, in its 2018 proposing release, set forth its observation on FINRA's prior application of "best interests": "While not an explicit requirement of FINRA's suitability rule, FINRA and a number of cases have interpreted the suitability rule as requiring a broker-dealer to make recommendations that are 'consistent with his customers' best interests' or are not 'clearly contrary to the best interest of the customer.'"[23] There is no indication that the SEC undertook sufficient legal analysis to assess the veracity of FINRA's "consistent with customers' best interest" interpretation of FINRA's suitability rule.

In an August 3, 2018 letter regarding the SEC's proposed Reg BI, FINRA again repeated its false claim, FINRA's suitability rule implicitly requires a broker-dealer's recommendations to be consistent with customers' "best interest."[24]

The SEC moved to finalize the rule hastily, under the influence of broker-dealer lobbying organizations. FSI had in the words of its leader, Dale Brown, "provided meaningful input" to the SEC.[25] As reported, "The effort definitely carries time urgency, according to FSI board member and Securities America advisor Kim Kropp, who notes the midterm elections and the next presidential election could shift the balance of power at the federal level. FSI and its allies 'have our chance to get something put in place,' Kropp says. 'The Department of Labor [rule] could be back, so let's get this done, get this nailed down.'"

Product Sales are Largely Incompatible with Acting in One's "Best Interest."

Those who sell products, and derive compensation from the sale of such products – especially when the recommendation of one product results in greater compensation to the broker than that of another broker – it is nearly impossible to adhere to the duties of a fiduciary. Time and again our courts have enumerated the fiduciary maxim: "No man can serve two masters."[26] As stated early on by the U.S. Supreme Court nearly two centuries ago:

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[21] As stated by Judge Paul Crotty in describing one broker-dealer's use of terms with established definitions, "Goldman's arguments in this respect are Orwellian. Words such as 'honesty,' 'integrity,' and 'fair dealing' apparently [in Goldman's eyes] do not mean what they say; [Goldman says] they do not set standards; they are mere shibboleths. If Goldman's claim of 'honesty' and 'integrity' are simply puffery, the world of finance may be in more trouble than we recognize." *Richman v. Goldman Sachs Group, Inc.,* 868 F. Supp. 2d 261 (S.D.N.Y. 2012).

[22] "Regulation Best Interest: The Broker-Dealer Standard of Conduct," U.S. Securities and Exchange Commission, 84 Fed. Reg. 33318-33492 (July 12, 2019).

[23] U.S. Securities and Exchange Commission, proposed rule, "Regulation Best Interest," 83 Federal Reg. 21574, at p.21577.

[24] FINRA reponse to Senators Warren and Booker (Aug. 3, 2018), at p.4.

[25] Tobias Salinger, "FSI Predicts Sec Will Issue Best Interest Rule Next Year," *Financial Planning* (Sept. 26, 2018).

[26] *See, e.g., Carter v. Harris*, 25 Va. 199; 1826 Va. LEXIS 26; 4 Rand. 199 (Va. 826) ("It is well settled as a general principle, that trustees, agents, auctioneers, and all persons acting in a confidential character, are disqualified from purchasing. The characters of buyer and seller are incompatible, and cannot safely be exercised by the same person. Emptor emit quam minimo potest; venditor vendit quam maximo potest. The disqualification rests, as was strongly observed in the case of the *York Buildings Company v. M'Kenzie*, 8 Bro. Parl. Cas. 63, on no other than that principle which dictates that a person cannot be both judge and party. No man can serve two masters. He that it interested with the interests of others, cannot be allowed to

"The two characters of buyer and seller are inconsistent: *Emptor emit quam minimo potest, venditor vendit quam maximo potest.*"[27]

And, as explained so eloquently by another jurist, "The characters of buyer and seller are incompatible, and cannot safely be exercised by the same person. *Emptor emit quam minimo potest; venditor vendit quam maximo potest.* The disqualification rests … on no other than that principle which dictates that a person cannot be both judge and party. No man can serve two masters. He that it interested with the interests of others, cannot be allowed to make the business an object of interest to himself; for, the frailty of our nature is such, that the power will too readily beget the inclination to serve our own interests at the expense of those who have trusted us."[28]

Reg BI – Some Good; A Work in Progress

This is not to say that Reg BI does not do *some good.* Certain sales contests in broker-dealer firms were eliminated. Some firms have adopted levelized commissions as a means of reducing conflicts of interest. But Reg BI largely remains a work in progress, with uncertain application. By its very nature, applying a "best interests" standard strictly to sales activities remains problematic.

Yet, at its core, I like to think of "Regulation Best Interest" as the securities industry's "Great Deception" – in the arguments advanced to policy makers. Consumers are also misled into believing they can trust their broker, while the relationship is not one of trust and confidence but rather largely an "arms-length" relationship with their broker.

"Arms-length" relationships are not evil, and they apply to the vast majority of service provider–customer engagements.[29] In arms-length relationships, the doctrine of "caveat emptor"[30] generally applies,[31] although there

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make the business an object of interest to himself; for, the frailty of our nature is such, that the power will too readily beget the inclination to serve our own interests at the expense of those who have trusted us."). *Id.* at 204.

[27] *Wormley v. Wormley*, 21 U.S. 421; 5 L. Ed. 651; 1823 U.S. LEXIS 290; 8 Wheat. 421 (1823). *See also Michoud v. Girod*, 45 U.S. 503; 11 L. Ed. 1076; 1846 U.S. LEXIS 412; 4 HOW 503 (1846) ("[I}f persons having a confidential character were permitted to avail themselves of any knowledge acquired in that capacity, they might be induced to conceal their information, and not to exercise it for the benefit of the persons relying upon their integrity. The characters are inconsistent. Emptor emit quam minimo potest, venditor vendit quam maximo potest."]

[28] *Carter v. Harris*, 25 Va. 199, 204 (1826); 1826 Va. LEXIS 26; 4 Rand. 199 (Va. 1826).

[29] *See, for example, Hartman v. McInnis, No. 2006-CA-00641-SCT (Miss. 11/29/2007)* ([O]rdinarily a bank does not owe a fiduciary duty to its debtors and obligors under the UCC … the power to foreclose on a security interest does not, without more, create a fiduciary relationship … a mortgagee-mortgagor relationship is not a fiduciary one as a matter of law."). "[T]he significant weight of authority holds that franchise agreements do not give rise to fiduciary … relationships between the parties." *GNC Franchising, Inc. v. O'Brien*, 443 F.Supp.2d 737, 755 (W.D. Pa., 2006).

[30] *Caveat emptor* is Latin for 'Let the buyer beware.' In its purest form at common law, in the absence of fraud, misrepresentation or active concealment, the seller is under no duty to disclose any defect; it therefore provides a safe harbor to a seller to not to disclose any information to a buyer. *See* Alex M. Johnson, Jr., "An Economic Analysis Of The Duty To Disclose Information: Lessons Learned From The Caveat Emptor Doctrine" (2007), available at http://law.bepress.com/cgi/viewcontent.cgi?article=9154&context=expresso. It means that a customer should be cautious and alert to the possibility of being cheated. The doctrine supports the idea that buyers take responsibility for the condition of the items they purchase and should examine them before purchase. This is especially true for items that are not covered under any warranty. *See, e.g. SEC v. Zandford*, 535 U.S. 813 (2002).

[31] "When parties deal at arm's length the doctrine of caveat emptor applies, but the moment that the vendor makes a false statement of fact, and the falsity is not palpable to the purchaser, he has an undoubted right to implicitly rely upon it. That would indeed be a strange rule of law which, when the seller has successfully entrapped his victim by false statements, and was called to account in a court of justice for his deceit, would permit him to escape by urging the folly of his dupe was not suspecting that he (the seller) was a knave." *Holcomb v. Zinke*, 365 N.W.2d 507, 511 (N.D., 1985).

are many exceptions made to this doctrine which effectively compel affirmative disclosure of adverse material facts in diverse contexts.[32] In other words, non-fiduciaries who contract with each other can engage in "conduct permissible in a workaday world for those acting at arm's length."[33]

But, to be in an arms-length relationship, while holding out as being bound to act in the customer's best interest, is just bizarre. Reg BI brings about the creation of trust, for "[t]rust is an expectation that others will act in one's own interest."[34] But, Reg BI, by failing to adopt a fiduciary duty of loyalty, also sets in motion the inevitable betrayals of that trust, with severe consequences for individual investors' faith in, and future participation in, the integrity of our capital markets.

Words have meanings. Words and phrases that have long-established meanings under the law should not be so casually re-defined by those interested in loosing restrictions or obligations imposed by such words. "Studies have shown that, as a result of loose language, investors are confused regarding the nature of the services offered by, and the standards of conduct applicable to, broker-dealers and investment advisers, and regarding whether their firm or financial professional is a broker-dealer or an investment adviser, or both."[35]

I may be an ole' country lawyer, but I know what comes out of the south end of a north-facing cow. Reg BI. Enough said.

Or … perhaps not, for as Professors James Angel and Douglas McCabe so eloquently stated in a 2010 white paper: "Where the fundamental nature of the relationship is one in which customer depends on the practitioner to craft solutions for the customer's financial problems, the ethical standard should be a fiduciary one that the advice is in the best interest of the customer. To do otherwise – to give biased advice with the aura of advice in the customer's best interest – is fraud."[36]

The Great Deception – it makes all of us who care about their fellow citizens a little angry.

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[32] It is well settled that fraud may occur without the making of a false statement. *Dvorak v. Dvorak*, 329 N.W.2d 868 (N.D.1983). The suppression of a material fact, which a party is bound in good faith to disclose, is equivalent to a false representation. *Verry v. Murphy*, 163 N.W.2d 721 (N.D.1969).

[33] *Meinhard v Salmon*, 249 NY 458, 464 (N.Y. 1928).

[34] David J. Seipp, Trust and Fiduciary Duty in the Early Common Law, 91 Boston U.L.Rev. 1011 (2011),

[35] SEC Commissioner Hester Pierce, "What's in a Name? Regulation Best Interest v. Fiduciary," Harvard Law School Forum on Corporate Governance (July 31, 2018), available at https://corpgov.law.harvard.edu/2018/07/31/whats-in-a-name-regulation-best-interest-v-fiduciary/, also stating: "A bigger concern for me is that the best interest standard suffers from the same problem the fiduciary standard does—a term that is wonderful for marketing purposes, but potentially misleading for investors … I would not refer to the standard as, or include within the standard, the term 'best interest.'" Despite her expressed misgivings regarding the use of the phrase "best interest" in Reg. BI, Commissioner Pierce voted in favor of the rule's adoption.

[36] James J. Angel, Ph.D., CFA and Douglas McCabe Ph.D., "Ethical Standards for Stockbrokers: Fiduciary or Suitability?" (Sept. 30, 2010). Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1686756.

Reg BI Should Be Replaced.

The SEC should move quickly to modify Regulation Best Interest, given the fact that the previous Commission was deceived by FINRA and broker-dealer lobbying organizations into believing that brokers already possessed some form of duty to act in their customer's best interest. To not act would be tantamount to a tacit approval by a victim of misrepresentation to the wrongful act perpetuated upon him or her, after learning of the harm. Worse, any failure by the SEC to swiftly modify Regulation Best Interest will result in more harm to individual investors with each passing day.

Associated with this modification should come, with due and deliberate consideration of all of the alternatives, replacement regulations to govern the standards of conduct for brokers. Any such regulation should return to the principle that the arms-length nature of the relationship between a broker and its customer should not be disguised. Honesty and candor should be required at all times.

In addition, specific rules could be enacted that eliminate many of the conflicts of interest present in broker-customer relationships, such as the elimination of payment for shelf space, further restrictions on the use of soft dollars, the elimination of 12b-1 fees, and even the cessation of payment for order flow arrangements. Point-of-sale (and point-of-recommendation) disclosures could be required, as well.

In the end, consumers deserve much greater clarity as to the nature of their relationship with any person or firm providing investment advice. Is the consumer in an arms-length relationship with a broker-dealer firm and its registered representatives? Or is the consumer in a relationship of trust and confidence with a registered investment adviser firm and its investment adviser representatives, in which the consumer can rely upon the trusted, expert advice of the adviser? What restrictions, if any, exist which might negate the provision of completely investment advice? What inducements, if any, might the provider of investment advice possess with respect to the advice provided?

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