BNA, INC.

SECURITIES REGULATION & LAW

REPORT

Reproduced with permission from Securities Regulation & Law Report, 41 SRLR 776, 4/27/2009. Copyright © 2009 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

REGULATORY REFORM

Six Degrees of Separation: Principles to Guide The Regulation of Broker-Dealers and Investment Advisers

BY MICHAEL KOFFLER

With each passing day, the calls from Capitol Hill, the SEC,[1] FINRA,[2] and various industry trade groups to ''harmonize'' the regulatory framework governing broker-dealers and investment advisers and establish a self-regulatory organization (''SRO'') for advisers grow louder. In the words of the SEC's Chairman, ''consumers of financial products and services must receive the same level of protection regardless of the product or service that they purchase.''[3] Accordingly, the SEC is studying whether to recommend legislation to ''break down the statutory barriers that require a different regulatory regime for investment advisers and broker-dealers.''[4] It is hard to argue with the notion of functional regulation and regulating those who provide similar services similarly. However, recent statements on functional regulation are based on a crucial premise: that broker-dealers and investment advisers provide the same services simply because they both provide investment advice about securities. While a superficial review supports this notion, closer analysis reveals that the activities of broker-dealers and investment advisers and the investment advice they provide differ in significant and meaningful ways.

Any effort to harmonize the regulatory regime governing broker-dealers and investment advisers that fails to properly account for these differences will result in poor public policy decisions and corresponding challenges for the financial services industry, the SEC and any future SRO for investment advisers. The risks and attendant problems of ignoring the degrees of separation between broker-dealers and investment advisers would increase if FINRA were to become the SRO for the advisory industry given its historical focus on broker-dealers.[5] This article analyzes important differ-

Michael Koffler is a partner with Sutherland in New York.

[1] ''SEC'' refers to the U.S. Securities and Exchange Commission.

[2] ''FINRA'' refers to the Financial Industry Regulatory Authority.

[3] Mary L. Schapiro, Remarks before the FINRA Fall Securities Conference (Oct. 23, 2008).

[4] SEC Chairman Mary L. Schapiro, testimony concerning enhancing investor protection and regulation of the securities markets before the Senate Committee on Banking, Housing and Urban Affairs (March 26, 2009).

[5] In recent months, FINRA has moved aggressively to position itself as an SRO for investment advisers. *See, e.g.*, Richard G. Ketchum, Chairman and CEO of FINRA, testimony before the Senate Committee on Banking, Housing, and Urban Affairs (March 26, 2009) (''FINRA is uniquely positioned from a regulatory standpoint to build an oversight program for investment advisers quickly and efficiently''); Stan Wilson and Sarah Ilene

ences between the activities of broker-dealers and investment advisers and underscores the public policy implications of these differences on any future attempt to harmonize the regulation of these two industries.[6]

I. How We Got Here

A. A Look At History

The current focus of the debate regarding the regulation of broker-dealers and investment advisers—the provision of investment advice—is largely the result of developments regarding brokerage industry compensation practices. In May 1994, at the request of then-SEC Chairman Levitt, and in response to concerns about conflicts of interest in the retail brokerage industry, a broad-based Committee on Compensation Practices was formed to recommend best practices. The committee was chaired by Daniel Tully, then Chairman and CEO of Merrill Lynch & Co., Inc. and became known as the ''Tully Committee.''[7] The Tully Committee issued its final report (''Tully Report'')[8] in April 1995, and among the best practices it identified was compensating registered representatives (''RRs'') based on client assets, regardless of transaction activity. In discussing this best practice, the report concluded that basing a portion of RR compensation on client assets in an account ''is seen as one way to reduce the temptation for income-seeking registered representatives to create trading activity in an account. . .'' The Tully Report also observed that in many cases the best advice an RR can give a client at a point in time is to do nothing. Moreover, the report noted that under a commission arrangement, an RR would not receive any compensation for providing investment advice, thereby putting pressure on the RR to have the customer ''do something.'' In short, the Tully Report saw fee-based brokerage as a best practice to better align the interests of RRs and clients.

The Tully Report was a major impetus for broker-dealers to re-evaluate their compensation practices. Fee-based accounts were given a further endorsement in an SIA best practices release issued in November 1996.[9] As fee-based brokerage accounts became more widespread, concerns arose among broker-dealers that such compensation could be viewed as ''special compensation,'' thereby invoking the Advisers Act.[10] The SEC entered the debate in November 1999 when it issued proposed Rule 202(a)(11)-1 under the Advisers Act, which stated that the form of compensation received by a broker-dealer would not, in and of itself, be determinative of whether an account is advisory or brokerage in nature. Ever since Rule 202(a)(11)-1 was proposed, the debate regarding investment advice provided by broker-dealers has largely centered on the role of compensation in determining whether the provision of such advice triggers investment adviser registration.

In recent years, FINRA and others have repeatedly called for an SRO to oversee the investment advisory industry. This suggestion is based in large part on the notion that there is an uneven playing field in the regulation of investment advisers and broker-dealers. For example, commentators and regulators have noted that broker-dealers are generally subject to a more stringent examination program by FINRA as compared to the SEC's examination of investment advisers:

> As the SEC has noted, the population of registered investment advisers has increased by more than 30 percent since 2005. Investment advisers now number 11,300—more than twice the number of broker-dealers. While the SEC has attempted to use risk assessment to focus its resources on the areas of greatest risk, the fact remains that the number and frequency of exams relative to the population of investment advisers has dwindled. Consider the contrast: FINRA oversees nearly 4,900 broker-dealer firms and conducts approximately 2,500 regular exams each year. The SEC oversees more than 11,000 investment advisers, but in 2007 conducted fewer than 1,500 exams of those firms. The SEC has said recently that in some cases, a decade could pass without an examination of an investment adviser firm.[11]

The justification for an SRO for investment advisers is thus largely based on a concern about the efficacy of the SEC's examination program in light of the tremendous growth in the number of investment advisers in recent years. Pending bills to require the registration of investment advisers to pooled investment vehicles, such as hedge funds, would put further stress on the SEC's examination program of investment advisers.

B. The Industry's Self-Inflicted Wounds

Due to the brokerage industry's movement to provide fee-based investment programs following the Tully Report, it became more difficult for the investing public to differentiate broker-dealers from investment advisers.[12]

Klein, *FINRA Stakes Claim to be Adviser SRO*, COMPLIANCE REPORTER, Jan. 30, 2009; Stephen Luparello, Interim Chief Executive Officer, FINRA, testimony before the House Financial Services Committee, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (Feb. 4, 2009); Stephen Luparello, Interim Chief Executive Officer, FINRA, testimony before the Senate Committee on Banking, Housing and Urban Affairs (Jan. 27, 2009); Remarks by Mary L. Schapiro, *supra* note 3.

[6] This article does not address investment advisers that provide services other than investment management to clients, such as financial planning or providing reports on securities.

[7] In May 1994, the SEC issued a report reviewing the hiring, retention and supervisory practices of nine of the largest broker-dealers in the country. *See* Large Firm Project Report, 93-95 CCH Dec., paragraph 85,348 (May 1994). The review was commenced because of concerns on the part of the SEC regarding the frequency and severity of sales practice abuses perpetrated by some registered representatives employed by broker-dealers. Shortly after the issuance of the report, then-Chairman Arthur Levitt announced the formation of the Tully Committee to review compensation practices for registered representatives. The Tully Committee was given three mandates: (1) to review industry compensation practices for registered representatives and branch managers; (2) to identify actual and perceived conflicts of interest for these individuals; and (3) to identify the ''best practices'' used in the industry to eliminate, reduce or mitigate these conflicts. Over the course of succeeding months, the committee solicited broad industry input. *See* NASD Notice to Members 94-69, *Committee on Compensation Practices Requests Comment; Comment Period Expires October 14, 1994* (September 1994).

[8] Report of the Committee on Compensation Practices, [1995 Decisions Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,614 (Apr. 10, 1995).

[9] Securities Industry Association Best Practices ''A Guide for the Securities Industry'' (Nov. 1996).

[10] ''Advisers Act'' refers to the Investment Advisers Act of 1940, as amended.

[11] Richard G. Ketchum, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, *supra* note 5.

[12] Many, including securities regulators, have referred to a ''convergence'' of the services provided by investment advisers and broker-dealers since the Tully Report. *See, e.g., id.* This depiction does not accurately describe the changes that have

 COPYRIGHT © 2009 BY THE BUREAU OF NATIONAL AFFAIRS, INC. ISSN 0037-0665

As these fee-based programs blossomed, the public could no longer rely on the pricing models historically used by broker-dealers to distinguish between the two industries. The movement of the brokerage industry toward fee-based programs that emphasized the investment advice provided has increased investor confusion.[13] So has the industry's practice of changing the titles of the RRs providing advice to their ''clients.'' As a result, many RRs are today called ''financial advisors,'' ''financial consultants,'' or ''adviser representatives.''

While the investment advisory industry has not repriced or changed its services as the brokerage industry has, it too has added to the public's confusion concerning the two industries by the way it markets its services. Copying a page from the brokerage industry, the investment adviser industry now commonly markets its advisory services as ''products.'' For instance, many investment advisers that manage client accounts on a discretionary basis now typically ''offer'' and advertise the performance of their various ''products''—essentially different model portfolios or composite accounts. Investment adviser advertisements often entail descriptions of how ''investors'' can ''invest in'' ''products'' that are ''offered'' or ''sold'' by advisers—terms that have their origin in securities distribution practices and which incorrectly suggest that investment advisers managing individual client accounts offer or sell interests in pooled investment vehicles or other securities.

Exacerbating the impact of poor language in advertising material is the advisory industry's adoption of various marketing practices that have long been used by the brokerage industry. In recent years, marketing arrangements have come to resemble distribution structures commonly utilized by broker-dealers. In fact, solicitation agreements are commonly referred to as ''product selling agreements'' that mimic selling agreements entered into between principal underwriters and selling broker-dealers to distribute investment company securities. Compensation arrangements entered into by investment advisers sometimes include revenue-sharing features that resemble the revenue-sharing arrangements common to mutual funds. Investment advisers often provide non-cash compensation to their associated persons that mimics the compensation paid in connection with the distribution of investment company securities and direct participation programs. Similarly, many investment advisers have adopted business entertainment and marketing practices, such as client appreciation events, that have been used by broker-dealers for years. And many firms dually registered as broker-dealers and investment advisers run the ''products'' that are ''sold'' by the firm through the same ''compensation grid'' without distinguishing between securities sold by the broker-dealer and advisory services provided by the investment adviser.

Recent testimony and speeches by the head of FINRA and certain SEC commissioners shows how much the lexicon used by the investment advisory industry during the past 10 to 15 years in its marketing material has begun to seep into the consciousness of securities regulators.[14] This is unfortunate because the way in which one views the client relationship has a profound impact on the way in which one views the regulatory framework for investment advisers and broker-dealers. In this respect, the investment advisory industry has done itself a disservice by copying longstanding broker-dealer practices. One result may well be regulation of investment advisers by an SRO that mimics FINRA's regulation of broker-dealers, a risk that obviously would increase significantly if FINRA itself were tapped to regulate investment advisers.

II. The Subject of Debate: How Investment Advisers and Broker-Dealers Vary in the Products and Services They Provide

The testimony, speeches and statements of the past few months would lead one to believe that broker-dealers and investment advisers essentially conduct the same functions, provide the same services and should be regulated in the same manner. However, the reality is very different. While many broker-dealers do provide investment advice, many other broker-dealers do not and instead focus their brokerage activities on clearing and settling trades, underwriting securities or serving as market makers, all fundamental services provided by the brokerage industry. These activities will continue to

occurred in the financial industry landscape. The services provided by the investment advisory industry have not materially changed in the past 15 to 20 years. On the other hand, following the Tully Report, broker-dealers began to market fee-based brokerage programs and to emphasize the importance of the investment advice they provide. Thus, the ''convergence'' described by FINRA and others merely reflects the trend by the brokerage industry to move closer to the investment adviser industry by emphasizing the investment advice they provide and changing their pricing structure to a fee-based model.

[13] *See, e.g.*, Angela Hung, et al., RAND Corp., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2007) (available at http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf).

[14] *See*, *e.g.*, Stephen Luparello, testimony before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, *supra* note 5 (''FINRA believes that it should be simpler for investors to know exactly what *product* they're buying, the legal protections they are entitled to and the qualifications of the person selling it. We believe that the solution to this problem is through greater regulatory harmonization – creating a regulatory system that gives retail investors the same protections and rights no matter what *product* they buy.'') (Emphasis added); Commissioner Elisse B. Walter, remarks at ''The SEC Speaks in 2009'' (Feb. 6, 2009) (''Reform also is needed to address the regulation of financial intermediaries such as broker dealers, investment advisers, and insurance agents. Currently, these intermediaries are regulated under different statutes, and sometimes by different regulatory bodies, even though they often provide similar products and services to investors. When your Aunt Millie walks into the local financial professional to ask for advice, she has no idea—nor should she—which set of laws governs the conduct of the person on the other side of the table. What she does need to know is that no matter who it is, or what *product* they are selling, she will receive a comparable level of protection.'') (Emphasis added) *See also* Richard G. Ketchum, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, *supra* note 5 (''Investors deserve a system where they can be confident they will receive certain basic protections regardless of what product they buy or what license their financial professional holds . . . Unfortunately, not all financial products come with these important attributes or protections. . . . we do believe that enhanced regulatory consistency is in the best interests of investors, especially in the four areas I mentioned, licensing, advertising, sales practice and disclosure.'')

be carried out by a sub-set of the broker-dealer population regardless of how the regulatory framework is revised. For those broker-dealers that specialize in the ''plumbing'' of the securities markets, there is not much for Congress to harmonize with the investment advisory industry.

The discussions on Capitol Hill and in the halls of the SEC, FINRA, state securities regulators and industry trade groups are thus occurring in a vacuum. To date, the debate has centered on the relatively small amount of overlap between broker-dealers and investment advisers—the provision of investment advice to individual investors. Little effort has been devoted to analyzing the ways in which broker-dealers and investment advisers differ. The discussion below examines certain critical issues and questions that should be considered in connection with any effort to overhaul the regulation of broker-dealers and investment advisers. Whether this effort takes the form of combining the regulation of the two industries under a single statutory regime, or modifying existing provisions of the 1934 Act,[15] the Advisers Act and the rules thereunder to make them more consistent, the following issues and questions must be addressed for any future regulatory regime to be successful.

A. Distributing and Selling Securities in Offerings While Providing Advice: Dueling Loyalties

A large number of broker-dealers enter into agreements with issuers, principal underwriters, syndicate members or wholesalers in order to obtain rights to distribute and participate in securities offerings (as well as the right to be compensated for their distribution efforts). Thus, with respect to offerings, these broker-dealers serve as principals for their own accounts or as agents of those for whom they engage in distribution efforts. This structure is mandated by applicable SRO rules[16] and is the way securities offerings have long been distributed to the public. Thus, in the context of offerings, broker-dealers act for their own account or as agents of the issuer, principal underwriter, syndicate members or wholesaler at the same time they provide advice and recommend the purchase of securities. These broker-dealers are contractually obligated (generally on a firm commitment or best efforts basis) to distribute the very securities that they provide advice and recommendations on to investors. The contractual arrangements underlying the distribution of securities offerings means that such broker-dealers have competing loyalties (on one hand to sell as much as possible and on the other hand to provide suitable investment advice) whenever they recommend and sell securities in offerings.

The contractual arrangements entered into by such broker-dealers and the corresponding loyalties and duties created thereunder would result in various questions and challenges for these firms should they be held to a fiduciary duty standard in the future. Accordingly, if recent recommendations to impose a fiduciary duty on broker-dealers[17] are implemented, Congress should address the conflicting loyalties that broker-dealers participating in offerings owe to issuers, principal underwriters and syndicate members, on one hand, and to the investors to whom they provide advice and recommendations, on the other hand. In particular, any future statutory regime should specify the extent to which broker-dealers can serve multiple masters while still acting in a fiduciary capacity.

B. The Fundamental Difference: the Nature of the Relationship

Fundamental to the difference between investment advisers and broker-dealers is their relationship with clients. It has long been recognized that under the current regulatory framework, broker-dealers and their RRs are ''salesmen'' vis-à-vis the investing public. While the standard governing investment advice provided by RRs can be readily changed via legislation, it will not be possible to revise one of the fundamental purposes served by many broker-dealers, which is to distribute and sell securities. The purpose served by investment advisers, however, is not to distribute or sell securities. Instead, investment advisers exist solely to provide investment advice to their clients. Thus, unlike broker-dealers, there usually is no alternative purpose or party to be served. The focus of the investment advisory relationship is thus not on the sale of a security, but the provision of advice.

In this respect, it is crucial to recognize that the investment advisory relationship is a personal relationship. When clients hire an investment adviser they are buying the intellectual capital, judgment and expertise of the adviser. This is why Section 205(2) of the Advisers Act provides that a registered investment adviser may not enter into an advisory contract unless the contract provides that it cannot be assigned by the adviser without the consent of the client.[18] The SEC has noted that the Advisers Act's ''legislative history mentions concern about fiduciaries assigning personal contracts and demonstrates that this provision is directed against persons who would otherwise 'traffic' in investment advisory contracts.''[19] Similarly, the Supreme Court has

---

[15] ''1934 Act'' refers to the Securities Exchange Act of 1934, as amended.

[16] *See, e.g.,* NASD Conduct Rule 2770 applicable to selling syndicate agreements; NASD Conduct Rule 2820 (''No member who is a principal underwriter as defined in the Investment Company Act of 1940 may sell variable contracts through another broker/dealer unless . . . (2) there is a sales agreement in effect between the parties.''); *see also* NASD Conduct Rule 3040, which prohibits ''selling away'' by RRs.

[17] *See, e.g.,* Commissioner Luis A. Aguilar, ''Increasing Accountability and Transparency to Investors,'' remarks at ''The SEC Speaks in 2009'' (Feb. 6, 2009) (''Today, as broker-dealers increasingly provide advice to their clients, we should consider whether the higher standards and fiduciary duties of advisers should also be applied to these broker-dealers''); North American Securities Administrators Association, NASAA Statement on Obama Administration's Principles for Financial Services Regulatory Reform Feb. 26, 2009 (''In the area of securities regulation, for example, we should impose the fiduciary duty—in addition to existing standards—on all securities professionals who provide investment advice, including broker-dealers''); Paul Schott Stevens, President and CEO of the Investment Company Institute, testimony on ''Investor Protection and the Regulation of Securities Markets'' before the Senate Committee on Banking, Housing, and Urban Affairs (March 10, 2009) (''We recommend that both types of intermediaries [broker-dealers and investment advisers] be held to a fiduciary duty to their clients.'')

[18] The term ''assignment'' is defined in section 202(a)(1) of the Advisers Act to include, among other things, any transfer of an investment advisory contract or any transfer of a controlling block of the adviser's outstanding voting securities.

[19] *See, e.g.,* Certain Transactions Not Deemed Assignments, Advisers Act Release No. 1013 (Feb. 21, 1986).

 COPYRIGHT © 2009 BY THE BUREAU OF NATIONAL AFFAIRS, INC. ISSN 0037-0665

observed that "the Committee Reports indicate a desire to preserve 'the personalized character of the services of investment advisers.' "[20]

There is an inherent tension between serving as an agent in the chain of distribution of a security and providing investment advice in a personal relationship in which you owe "an affirmative duty of 'utmost good faith.' "[21] Fiduciary relationships are service relationships in which fiduciaries owe two types of broad duties to their clients: a duty of loyalty and a duty of care.[22] Fiduciary law vests in entrustors (those who are in a relationship with a fiduciary) the legal right to rely on the honesty of their fiduciaries and to receive quality fiduciary services.[23]

1. Principal Transactions

Fiduciaries generally may not create situations in which their interests conflict with those of entrustors. However, because such transactions could benefit both parties, the law does not disallow them altogether. Such transactions are permitted only with the fully informed consent of entrustors, or third parties on their behalf. These consents are aimed at assuring that the terms of the transactions mirror those reached at arm's length negotiations.[24] Thus, for instance, Section 206(3) of the Advisers Act prohibits an investment adviser from directly or indirectly entering into a principal transaction with a client (*i.e.*, buying securities from or selling securities to a client for the adviser's own account) unless the adviser has notified the client in writing *and* obtained the client's informed consent to the transaction.[25] The statute was intended to address the potential for self-dealing that can arise when an investment adviser (or an affiliate) acts in a principal capacity in transactions with clients, such as through price manipulation or the dumping of unwanted securities into client accounts.[26] As a result, Section 206(3) requires, among other things, an investment adviser to disclose in writing *before* the completion of *each* such transaction the capacity in which the investment adviser is acting and to obtain the client's consent.[27]

Broker-dealers that make markets in securities or hold positions via proprietary accounts regularly buy securities directly from, and sell securities directly to, their customers. Any requirement to seek and obtain the prior consent of customers before engaging in principal transactions would have a materially adverse impact on these firms' businesses. However, the principles of fiduciary law appear to mandate such a process. In order to allow entrustors to make informed decisions, fiduciaries must provide entrustors with all material information regarding the transaction and give them the ability to consent to (or reject) the transaction.[28] Thus, if broker-dealers have the fiduciary mantle thrust upon them, then it would seem they should be subject to the consent process set forth in Section 206(3) of the Advisers Act for principal trades.

If this consent process is not mandated for broker-dealers, then there is a risk that bestowing a fiduciary duty on them could (1) amount to little more than window dressing (*i.e.*, a designation that will be used for little more than marketing purposes) and (2) result in investor confusion. After all, the result would be disparate treatment of two types of fiduciaries engaged in the same activity. In such circumstances, it is natural to wonder how one fiduciary (a broker-dealer) can engage in principal transactions without obtaining the prior, informed consent of clients while another fiduciary (an investment adviser) must obtain such consent in order to engage in the same type of transactions. Importantly, even if the regulatory regime is revised such that there no longer are separate categories of broker-dealers and investment advisers in the future, this issue will still need to be addressed since those engaged in distributing securities will likely continue to provide advice on securities.

2. How Far To Go—Toward a Universal Standard?

The foregoing discussion touches on a much broader question: What should be the extent of a broker-dealer's fiduciary duty? One must observe, as the Supreme Court did more than 65 years ago, that:

> [T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?[29]

Likewise, to conclude that broker-dealers have a fiduciary duty when providing investment advice is merely the beginning of the analysis. One important question relates to the extent of the duty: Should it be imposed on all broker-dealers? After all, not all broker-dealers even provide investment advice (or other services) to retail customers. For instance, clearing firms, market makers, online brokerage firms, dealers, execution-only firms and wholesalers typically do not. Thus, a significant segment of the brokerage industry does not interact with the investing public. Do public policy con-

---

[20] SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180, 191 (1963).

[21] *Id*. at 194.

[22] Tamar Frankel, *Fiduciary Duties, in* 2 The New Palgrave Dictionary of Economics and the Law 127 (Peter Newman, ed., 1998).

[23] *Id.* at 130. The duty of care requires fiduciaries to perform their services with care and skill that can reasonably be expected of them in the particular situation. It requires them to gather pertinent information, deliberate before making a decision and use their skills in the process. The standard of care that fiduciaries must exercise often is measured by the care that they exercise in their own affairs. *Id.*

[24] *Id.* at 129.

[25] *See* Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Advisers Act Release No. 1732 (July 17, 1998); In re Gintel Asset Mgmt., Advisers Act Release No. 2079 (Nov. 8, 2002). The SEC and its staff have interpreted Section 206(3) to apply not only to principal transactions engaged in or effected by an adviser, but also to principal transactions effected by affiliates that control, are controlled by, or are under common control with the adviser.

[26] *See Investment Trusts and Investment Companies: Hearings Before the Subcomm. of the Comm. on Banking and Currency*, 76th Cong., 3d Sess. 320-22 (1940).

[27] Pursuant to Temporary Rule 206(3)-3T, which remains in effect until December 31, 2009, firms that are dually registered with the SEC (as both an investment adviser and a broker-dealer) may engage in principal transactions in securities with their non-discretionary advisory clients, subject to a number of conditions. Importantly, the relief would not apply to principal trades involving (i) securities issued by the dual registrant or an affiliate or (ii) securities (other than investment grade, non-convertible debt) underwritten by the dual registrant or an affiliate.

[28] *See* Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 Or. L. Rev. 1209 (Winter 1995).

[29] SEC v. Chenery Corp., 318 U.S. 80, 85 (1943).

cerns dictate that such firms be subject to a fiduciary duty? What exactly are the public policy principles and mandates that need to be addressed? Is it possible to impose a limited fiduciary duty on broker-dealers that arises only when they provide advice to investors? Is such a paradigm possible? If so, is it desirable? These broader questions must be considered and analyzed before a decision is made as to the regulation of financial intermediaries.

Even where a given broker-dealer does provide investment advice to an investor and the fiduciary duty attaches, should the duty cover all of the firm's activities? Should the generation of research reports be subject to a fiduciary duty? What about TRACE, OATS, ACT, FOCUS, Rule 3070, Form U4 and Form U5 filings? What about securities lending activities? Advertisements? Fairness opinions? Underwriting and syndicate activity? Market making activity? Settlement functions? Imposing a fiduciary duty on these and other activities could have very significant repercussions and could potentially mean that some of them would become illegal or would need to be significantly revised. Accordingly, there needs to be a debate about the merits of imposing a fiduciary duty on such activities before the decision is made. However, the superficial public discourse to date lacks any analysis of these questions.[30]

C. Disclosure

Investment advisory clients have the responsibility, based on disclosure they receive, to select their own investment advisers, negotiate their own fee arrangements, and evaluate their advisers' conflicts of interest. Therefore, as the SEC has stated, ''it is critical that clients and prospective clients receive sufficient information about the adviser and its personnel to permit them to make an informed decision about whether to engage an adviser, and having engaged the adviser, how to manage that relationship.''[31] Since 1979, the SEC has required an investment adviser registered with it to provide clients and prospective clients with a disclosure statement providing information about the adviser, its services, business practices, fees, and conflicts of interest. Part II of Form ADV, the form advisers use to register with the SEC under the Advisers Act, sets out the requirements for the disclosure statement. In addition, Sections 206(1) and (2) of the Advisers Act address potential conflicts of interest by imposing a fiduciary duty on an investment adviser with respect to its clients and a duty of full and fair disclosure of all material facts.[32]

If broker-dealers were considered fiduciaries, it would appear necessary for them to provide a similar disclosure document covering these areas (particularly with respect to conflicts of interest) to investors at the beginning of the customer relationship.[33] In this respect, the limited information provided by confirmations at or before completion of a transaction, as required by Rule 10b-10 under the 1934 Act, is not sufficient. In addition, there is a view held by some in the industry that fiduciaries must actually provide material information to clients and cannot rely on an ''access equals delivery'' disclosure approach (under which disclosure that is accessible to clients satisfies the disclosure obligation). To the extent the SEC staff applies an ''actual delivery'' standard to investment advisers because they are fiduciaries, it would seemingly have to apply the same standard to broker-dealers if they are made fiduciaries.

Another question arises from the brokerage industry's widespread use of pre-dispute arbitration clauses. Notwithstanding the Supreme Court's approval of such clauses, with appropriate disclosure, in brokerage contracts with clients,[34] the SEC staff has in the past taken the position that mandatory arbitration provisions generally may not be included in advisory contracts.[35] In particular, the SEC staff took the position that the use of a clause requiring the parties to settle disputes arising out of an advisory contract by arbitration may violate the antifraud provisions of Section 206 of the Advisers Act because it may mislead clients to believe that they are barred from exercising their rights of action under the federal securities laws. To the extent the staff still holds this view, it would raise a question as to the appropriateness of such clauses by broker-dealers that are fiduciaries.

D. The Nature of the Advice: Portfolios vs. Transactions

Like many of its rules, FINRA's suitability rule, Conduct Rule 2310, is transaction-based. If a transaction is recommended by a broker-dealer, Rule 2310 requires the firm, among other things, to have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his/her financial situation and needs.[36] Similarly, Rule 3010(d) requires a registered principal to review and endorse every securities transaction effected through a broker-dealer.

---

[30] The public discourse also is rife with discussion of investment advisers' fiduciary duty on one hand and broker-dealers' suitability obligation on the other hand. This comparison is misplaced for a number of reasons. First, broker-dealers' suitability obligations arise only in the context of securities recommendations, whereas investment advisers' fiduciary obligations are ever present and govern all of their activities. In this respect, a much better comparison is between investment advisers' fiduciary obligations and broker-dealers' obligations under FINRA Rule 2010 to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Second, as discussed below, when recommending securities, the SEC views investment advisers as having an obligation to provide, in its words, ''suitable'' investment advice.

[31] Amendments to Form ADV, Advisers Act Release No. 2711 (March 3, 2008).

[32] *See also* SEC v. Capital Gains *supra* note 20.

[33] In 2004, the SEC proposed to require point-of-sale disclosure for broker-dealers selling certain types of securities. Confirmation Requirements and Point-of-Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Investment Company Act Release No. 26341 (Jan. 29, 2004). As fiduciaries, broker-dealers would be required to provide material information to investors to enable them to make informed hiring decisions regardless of the securities that are sold.

[34] Shearson/Am. Express v. McMahon, 482 U.S. 220 (1987).

[35] McEldowney Financial Services, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 78,373 (Oct. 17, 1986).

[36] The Rule also requires the broker-dealer, prior to the execution of a transaction recommended to a non-institutional customer (other than transactions with customers where investments are limited to money market mutual funds), to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, and such other information used or considered reasonable in making recommendations to the customer.

 COPYRIGHT © 2009 BY THE BUREAU OF NATIONAL AFFAIRS, INC. ISSN 0037-0665

As fiduciaries, investment advisers also owe their clients a duty to provide only suitable investment advice. While the Advisers Act does not expressly impose a suitability requirement on advisers, such a requirement is implicit in the antifraud provisions of Section 206 and has been enforced by the SEC. Discharging this duty requires an adviser to make a reasonable inquiry into the financial situation, investment experience, and investment objectives of the client and to reasonably determine that the investment advice is suitable for the client. However, the Advisers Act is not focused on specific transactions (as are Rules 2310 and 3010)—and for good reason.

In 1994, the SEC proposed Rule 206(4)-5 under the Advisers Act. The rule would have expressly stated that an investment adviser is prohibited from making unsuitable recommendations to clients.[37] The rule would have required an adviser, before providing any investment advice, and as appropriate thereafter, to make a reasonable inquiry into the client's financial situation, investment experience, and investment objectives. The proposing release noted that the extent of the inquiry would turn on what is reasonable under the circumstances. The proposal also would have required advisers to make inquiries to update information concerning the client. The frequency of such updates would have depended on what is appropriate under the circumstances.[38]

The proposed rule would have prohibited an adviser from giving advice to a client unless the adviser reasonably determined that the advice was suitable given the client's financial situation, investment experience, and investment objectives. Importantly, suitability of the advice would be evaluated in the context of the client's overall portfolio. In addition, the proposal would not have required advisers to memorialize the suitability considerations underlying each and every recommendation to clients. This makes sense. Investment advisers that manage client assets on a discretionary basis manage the overall portfolio; the focus is properly on the aggregate portfolio and not on particular holdings. Accordingly, even a client with an aggressive investment objective will likely have some conservative positions, and a client with a conservative investment objective will likely have some aggressive positions. The key is how the various positions fit together.

It is neither practical nor desirable from a public policy perspective to force investment advisers with management authority over clients' assets to focus on individual positions. Any future SRO for investment advisers needs to recognize the difference between recommending particular transactions and managing a portfolio. This would be particularly important if FINRA were to become the SRO for investment advisers since FINRA's rules currently impose approval requirements on all transactions. As is the case with the other issues discussed herein, even if broker-dealers and investment advisers were combined under a single statutory regime, Congress would have to recognize and account for the differences between managing a portfolio and recommending a single securities transaction.

The 1994 rule proposal also highlights another difference between investment advisers and broker-dealers. When investment advisers manage a portfolio they are tasked with *ongoing* management responsibility over the portfolio. They have a duty to monitor, review and adjust the portfolio on an ongoing basis in accordance with the client's investment objectives, guidelines and restrictions, and changing market conditions. The 1934 Act and FINRA rules, however, naturally focus on individual securities transactions.[39] A broker-dealer's suitability duty under Rule 2310, for instance, ceases with the purchase, sale or exchange of the security. As the SEC itself has stated, ''[u]nlike the sale of a single security or other products and services, the service provided by an investment adviser typically involves an ongoing personal relationship . . .''[40] This further underscores the importance of having rules for investment advisers that focus on clients' portfolios and not on particular transactions.

E. Custody

The Madoff ponzi scheme has focused significant attention on the custody of client assets. An investment adviser with legal custody of client assets must maintain client funds and securities with one or more ''qualified custodians.''[41] The qualified custodian must maintain client funds and securities in a separate account for each client under the client's name or in accounts containing only client assets under the adviser's name as agent or trustee for its clients. Thus, investment advisers are not legally permitted to maintain client funds or securities unless they are a ''qualified custodian'' as defined by Rule 206(4)-2 under the Advisers Act.[42] It is because investment advisers are not able to maintain client funds or securities that they are not subject to net capital or asset segregation requirements. Any future SRO overseeing investment advisers should recognize that imposing such requirements on investment advisers is unnecessary.[43]

[37] Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Advisers Act Release No. 1406 (Mar. 16, 1994). The SEC never adopted the proposed rule in part because it concluded that an explicit suitability rule was unnecessary given advisers' fiduciary duty under Section 206 of the Advisers Act.

[38] *Id.*

[39] After all, Section 3(a)(4)(A) of the 1934 Act defines ''broker'' as any person engaged in the business of effecting transactions in securities for the account of others.

[40] Telemarketing And Consumer Fraud And Abuse Prevention Act; Determination That No Additional Rulemaking Required, Exchange Act Release No. 38480 (Apr. 7, 1997).

[41] Rule 206(4)-2 under the Advisers Act.

[42] ''Qualified custodians'' are defined to include: banks; savings associations so long as the association's deposits are FDIC insured; broker-dealers registered with the SEC who hold client assets; futures commission merchants registered with the Commodity Futures Trading Commission; and foreign financial institutions that customarily hold financial assets for their customers, provided these institutions maintain advisory clients' assets in customer accounts segregated from their proprietary assets. Rule 206(4)-2(c)(3) under the Advisers Act.

[43] Fortunately, the SEC recognizes the mechanics of investment adviser custody arrangements and is considering proposals to require investment advisers with legal custody under the Advisers Act to undergo an annual third-party audit, on an unannounced basis, to confirm the safekeeping of client assets. The SEC may also consider requiring a senior officer from each firm to attest to the sufficiency of the controls they have in place to protect client assets. Mary L. Schapiro, Chairman of the SEC, testimony concerning enhancing investor protection and regulation of the securities markets before the Senate Committee on Banking, Housing and Urban Affairs (March 26, 2009).

F. Being a Fiduciary and Providing 'Solely Incidental' Advice—A Figment of the Imagination?

Section 202(a)(11)(C) of the Advisers Act excludes broker-dealers from the definition of investment adviser only where any investment advice they provide is ''solely incidental'' to their brokerage business and when they receive no special compensation therefor. To conclude that the provision of investment advice by broker-dealers implicates fiduciary law seems inconsistent with the notion in Section 202(a)(11)(C) that broker-dealers are not able to provide investment advice unless it is ''solely incidental'' to their brokerage activities without being subject to the Advisers Act.[44] Is it tenable to conclude that the advice provided by an RR of a broker-dealer is so important to the relationship with investors that it merits the protection of fiduciary law but at the same time is ''solely incidental'' to the brokerage services that are provided?

The two notions are difficult to reconcile. If Congress concludes that investment advice provided by broker-dealers and their RRs merits the protection of fiduciary law, it would seem that the ''solely incidental'' provision in Section 202(a)(11)(C) would either require all broker-dealers to register as investment advisers or become meaningless. Therefore, if Congress were to subject investment advice provided by broker-dealers to the protection of fiduciary law, then it must also address the language in Section 202(a)(11)(C).

G. Another Debate: Rules vs. Principles Regulation

The Advisers Act and the rules thereunder are perhaps the epitome of principles-based regulation. On the other hand, ''[b]roker-dealer regulation is subject to a very detailed set of rules established and enforced by FINRA,'' as the former interim head of FINRA has observed.[45] It is important for any future SRO for investment advisers to recognize the difference between the two approaches and to appreciate the statutory framework under which investment advisers are regulated. Looking to the rulebooks of FINRA, the New York Stock Exchange, and the Municipal Securities Rulemaking Board, it is difficult not to conclude that broker-dealer SROs regulate through the use of very detailed, specific sets of rules. Applying this approach to an industry subject to a principles-based statutory scheme that has been regulated via principles-based rulemaking by the SEC for nearly seven decades would cause significant disruption to the industry and may not be in the public interest.

Fiduciary duty principles evolved from the law of equity. These principles, by their nature, are not susceptible to detailed rules. The scope of a fiduciary's duty under the law necessarily and purposely varies depending on the scope of authority, the ability of entrustors to control the fiduciary, the ability of entrustors to monitor their fiduciary, the extent of power and entrustment provided to the fiduciary, the nature and extent of the services provided by the fiduciary and various other factors.[46] Given the equitable nature of fiduciary law, it is not tenable to set forth a fiduciary's responsibilities in a detailed manner or to specify a convention to govern their activity. Nor would it be in the public interest to do so. And it certainly would not be consistent with the way fiduciary law has evolved and been interpreted for hundreds of years. Any future SRO for investment advisers must give proper deference to this history and to the construction and interpretation of fiduciary law.

In this respect, FINRA's experience in regulating broker-dealers does not necessarily mean it is well-suited to serve as the SRO for investment advisers. It has limited experience with investment advisers and has developed a very detailed rules-based system that is transaction-based, not portfolio-based. In addition, senior representatives have made statements that give credence to critics concerned that FINRA would regulate investment advisers in a manner similar to its regulation of broker-dealers. For instance, in recent Congressional testimony a senior FINRA representative described investment advisers as marketing products to their clients and supported enhanced regulatory consistency in, among other things, ''sales practice[s]'' between broker-dealers and investment advisers.[47] Similarly, the former interim head of FINRA has testified that ''[i]nvestors should receive the same protection regardless of which product—mutual funds, hedge funds, or investment advice—they choose.'' [48] Such statements suggest that FINRA views investment advisers as being engaged in the sale of securities and other financial products (rather than in the provision of investment advice).[49]

Thus, while FINRA has an infrastructure (including trade, registration, offering, complaint and financial and operational reporting systems) and examination program that are state of the art and unmatched in the securities industry, it would face a steep learning curve were it to be granted jurisdiction over investment advisers. It would need to learn about investment advisers and how they operate and absorb almost 70 years of regulatory guidance and interpretation before it could be expected to effectively regulate the advisory industry. FINRA clearly thinks it is up to the challenge. In recent testimony, the Chairman and CEO of FINRA stated that ''FINRA is uniquely positioned from a regulatory standpoint to build an oversight program for investment advisers quickly and efficiently.''[50] However, it is fair to inquire how FINRA could ''quickly and efficiently'' build an oversight program for investment advisers when it does not have a lot of practical experience with the industry. If there will be an SRO for investment advisers (a subject beyond the scope of this article), then FINRA will face a challenge in convincing the advisory industry that it should fulfill that role. For its part, the advisory industry is concerned that FINRA would pigeonhole the industry into the existing regula-

[44] Of course, this would not be an issue under the Advisers Act if every broker-dealer that provides investment advice and is a fiduciary were made subject to the Advisers Act. However, it is difficult to imagine that Congress would take this approach in any attempt to harmonize the regulatory regime governing broker-dealers and investment advisers.

[45] Stephen Luparello, testimony before the House Financial Services Committee, *supra* note 5.

[46] *See* Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795 (May 1993).

[47] *See* Richard Ketchum, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, *supra* note 5.

[48] Stephen Luparello, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, *supra* note 5. *See also* note 14 *supra*.

[49] Such sales activity may legally only be conducted by broker-dealers.

[50] *See* Richard Ketchum, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, *supra* note 5.

 COPYRIGHT © 2009 BY THE BUREAU OF NATIONAL AFFAIRS, INC. ISSN 0037-0665

tory framework for broker-dealers. In this respect, FINRA's statements about the need to consistently regulate broker-dealers and investment advisers serve to increase the advisory industry's concerns.

III. The Other Side of the Coin—Placement and Execution of Securities Trdes

As a result of the Tully Report and the adoption of Rule 202(a)(11)-1, the SEC and the financial services industry have focused on how the provision of investment advice by broker-dealers and investment advisers should be regulated. Very few, however, have focused on what might be termed the ''other side of the coin'': Should the regulation of broker-dealers and investment advisers vary when it comes to the placement and execution of securities trades?

Many, if not most, introducing broker-dealers are links in the chain in processing securities transactions. They take orders from clients and transmit them to their clearing firms for clearance and settlement. This is enough to come within the definition of ''broker'' under the 1934 Act in large part because the sine-qua-non of broker-dealer activity has long been viewed to be the receipt of transaction-based compensation.[51] Interestingly, in describing the activity of broker-dealers in ''effecting'' securities transactions for purposes of Section 28(e) of the 1934 Act, the SEC has stated:

> The Proposing Release identified four minimum criteria that an introducing broker-dealer must satisfy in order to be 'effecting' transactions . . . At the same time, we believe that the statutory term 'effecting' requires that, in order for the money manager to use the safe harbor, a broker-dealer that is 'effecting' the trade must perform at least one of four minimum functions and take steps to see that the other functions have been reasonably allocated to one or another of the broker-dealers in the arrangement in a manner that is fully consistent with their obligations under SRO and SEC rules. The four functions are: (1) taking financial responsibility for all customer trades until the clearing broker-dealer has received payment (or securities) . . . ; (2) making and/or maintaining records relating to customer trades required by SEC and SRO rules, including blotters and memoranda of orders; (3) monitoring and responding to customer comments concerning the trading process; and (4) generally monitoring trades and settlements.[52]

It is difficult to argue that investment advisers do not also provide most of these same services. After all, most investment advisers that manage funds on a discretionary basis make and retain records related to customer trades required by SEC rules, monitor and respond to customer comments concerning the trading process and generally monitor trades and settlements. The SEC itself has effectively acknowledged as much. In discussing the application of the restrictions in Section 206(3) of the Advisers Act to cross trades, the SEC wrote:

> Section 206(3) applies when an adviser, ''acting as broker for a person other than . . . (a) client,'' causes the client to buy or sell a security from that other person. The Advisers Act, however, does not define when an investment adviser is ''acting as broker'' with respect to a particular agency transaction . . . We have concluded that if an investment adviser receives no compensation (other than its advisory fee), directly or indirectly, for effecting a particular agency transaction between advisory clients, the adviser would not be ''acting as broker'' within the meaning of Section 206(3). As we note above, it is primarily the incentive to earn additional compensation that creates the adviser's conflict of interest when effecting an agency transaction between advisory clients.[53]

Accordingly, if an investment adviser were to earn a commission when effecting a cross trade between clients, it would be acting as a ''broker'' for purposes of Section 206(3).[54] Thus, the question of the proper role of the form of compensation in determining how a given activity is regulated arises not only when considering how to regulate the provision of investment advice but also in considering the execution of securities trades. If one is committed to abide by SEC Commissioner Walters' prescription to ensure that ''[t]he rules that apply to someone ought to depend on what they're doing, not what they call themselves and not necessarily on how they charge people,''[55] then Congress, the SEC and the industry must focus not only on the provision of investment advice but also on the placement and execution of trades. In this respect, the role played by the typical introducing broker-dealer in submitting trades with its clearing firm varies little from that played by an investment adviser in placing trades with a qualified custodian.[56] If this is correct, it would be inconsistent and intellectually dishonest for Congress, securities regulators and others to assert that functional regulation is mandated with respect to the provision of investment advice but not with respect to the placement of securities trades.

IV. A Possible Approach

One possible approach to harmonizing the regulation of broker-dealers and investment advisers would be to have true functional regulation—regulation that is based solely on the nature of the function being performed. This approach would combine the regulation of broker-dealers and investment advisers within a single statutory framework. More importantly, however, it would categorize financial service intermediaries based on the activities they conduct, such as (but not limited to):

- Clearance and settlement
- Market making
- Underwriting

[51] Section 3(a)(4)(A) of the 1934 Act defines the term ''broker'' to mean ''any person engaged in the business of effecting transactions in securities for the account of others.''

[52] SEC Guidance Regarding Client SEC Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006).

[53] Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Advisers Act Release No. 1732 (July 17, 1998).

[54] While the SEC's statements are, on their face, limited to Section 206(3) of the Advisers Act, it is logical to think that the same conclusion would be reached under a 1934 Act analysis.

[55] SEC Shows Interest in Fiduciary Issue, Investment News, February 23, 2009.

[56] Of course, under current law, introducing broker-dealers are subject to different books and records requirements, order ticket requirements and supervision requirements when placing a trade with their clearing firms than investment advisers are when placing trades with their custodians. In addition, broker-dealers are subject to such requirements as the obligation to send confirms under Rule 10b-10 under the 1934 Act. However, the activity triggering these differences—placing a securities trade with a third party (in one case with a clearing firm and in the other with a custodian)—is essentially the same.

- Selling group participant
- Syndication
- Wholesaling
- Retailing
- Executing trades (without providing investment advice)
- Brokering private placements
- Generating and distributing research reports and other publications that are ''impersonal'' in nature
- Financial planning
- Providing advice regarding the purchase, sale or exchange of particular securities
- Portfolio management.[57]

Under this approach, the regulatory framework would be tiered, based on the activities carried out by a financial intermediary. Regulation would thus be tailored to the specific activities that are engaged in by the intermediary. In order for this structure to be effective, a different set of rules, restrictions and obligations would exist *for each* listed activity. Firms engaged in multiple activities listed above would of course be subject to multiple sets of requirements, each one of which regulates a specific activity. Today, this is not the case—even for firms that are broker-dealers.

The list above distinguishes between investment advice that is provided about a security and investment management of a securities portfolio. As discussed above, there are significant differences between these two activities and the regulatory framework should reflect these differences. Others might draw different distinctions (such as between discretionary and non-discretionary portfolio management) and/or create different or additional categories. While such details are very important, they are less significant than the overall structure and framework of regulation. It is essential that consensus first be reached on the overall approach to regulation.

[57] Some of these activities are listed on Form BD, the registration form for broker-dealers.

V. Conclusion

The investment adviser and broker-dealer industries have existed side by side for almost 70 years. During this time, the two industries have grown, evolved and become more complex. Any attempt to integrate these two industries or materially revise the standards governing them will involve intricate issues and tough choices. This article discusses some of these issues with the hope that it will cause those in a position to effect future regulatory change to thoughtfully consider the consequences of harmonizing the regulatory framework for broker-dealers and investment advisers. Whether the future brings a single regulatory regime for these two industries or more consistency between the 1934 Act and the Advisers Act and the rules thereunder, there will still be entities that: serve as market makers and make orderly markets in securities; serve as dealers and trade for their own accounts; serve as principal underwriters or syndicate members and underwrite and distribute offerings; serve as wholesalers and market securities and other financial products to ''downstream'' selling firms; provide only online brokerage services; or execute trades and provide advice to clients. Regardless of the shape and form of the future regulatory scheme, these various services will continue to be provided—sometimes within the same company. Accordingly, any attempt to reform the regulatory framework for broker-dealers and investment advisers must account for and recognize these different activities.

We are standing on the precipice of tremendous change in the financial services industry—change that can improve the regulation of the industry and increase the confidence of the investing public or change that can weaken the industry, the rule of law and the faith of the public in institutions that provide investment advice. While there is tremendous opportunity for positive change, there is also risk of unintended and harmful consequences. We need to carefully analyze the various issues before decisions are made if we are to improve the regulatory structure for broker-dealers and investment advisers. It is time for this incredibly important debate to begin in earnest.

 COPYRIGHT © 2009 BY THE BUREAU OF NATIONAL AFFAIRS, INC. SRLR ISSN 0037-0665