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EXECUTIVE SUMMARY

In June 2019, long-standing principles and practices were swept aside by conduct standards rulemaking by the U.S. Securities and Exchange Commission (SEC). The rulemaking ignores structural, business, and legal differences between brokers and advisors regarding their purposes, roles, and functions. Brokers, in their commercial roles, are incentivized to sell products for issuers or manufacturers in relationships of three. Advisors are compensated by clients as fiduciaries in relationships of two.

The rulemaking completed the SEC's decade-long effort to "harmonize" brokerage sales with advisors' fiduciary advice in the eyes of investors and broker–dealers. As a result, conflicts of interest have been rebranded as "normal, ubiquitous and acceptable"; avoiding conflicts is generally neither recommended nor required.

The rulemaking includes Reg BI, Form CRS*, and interpretive guidance on the Investment Advisers Act of 1940—and it is transformational. Investment-advisor practices and assumptions that put client interests first and made avoiding conflicts the rule have been substituted with *caveat emptor* thinking and differences have been muted. The message is that brokers and advisors are "indistinguishable," as then SEC Chair Mary Schapiro stated in 2009.

In 2025, the new SEC will usher in different priorities and thinking on a range of issues. Conservative- and libertarian-leaning policymakers and lobbyists do not support fiduciary duties. However, many of them do support improved disclosure. To be clear, disclosure is no equivalent or substitute for enforcing fiduciary practices. Yet disclosure that is clear, concise, and meaningful can help investors make better choices that better serve their interests. Fiduciary and investor advocates should seek disclosure that works and start with Form CRS, and research reveals that improvements are possible.

**Regulation Best Interest, https://www.sec.gov/rules/final/2019/34-86031.pdf; U.S. SEC (2018) Appendix B: Form CRS, https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf. p. 14.*

Boston University law professor Tamar Frankel distills the meaning of the fiduciary duty of loyalty to two aspects. The first is acting "for the sole benefit" of the client. The second aspect is a prohibition from "acting in conflict with the interests" of the client. The importance of conflicts is clear.[1]

The U.S. Securities and Exchange Commission's (SEC) 2019 conduct standards rulemaking, and Regulation Best Interest (Reg BI)[2] especially, rejects basic fiduciary principles that distinguish advisors and brokers. Conflict disclosure or mitigation take on new importance in delivering a fiduciary/best interest standard. Procedures matter greatly.[3]

The importance of this rulemaking is hard to overstate. This article seeks to explain why. It is also written to remind us that fixes can help. How the rulemaking is interpreted, applied, and enforced will matter greatly.

First some background: Investment advice once meant "fiduciary advice." Well-established legal and structural differences separated advisors and brokers based on longstanding principles.

The Investment Advisers Act of 1940 ("Advisers Act") underscored the nature of investment advice, the lethal nature of conflicts, and the differences that distinguish investment advisors from sales brokers. "Legitimate advisory organizations" differ from conflicted sales of "tipsters and touts." Leading advisors advocated that investment advice should be compensated only by fees and advisors should not be in other businesses. In 1963 the Supreme Court recognized that advisors owed fiduciary duties under the Advisers Act.[4]

These views prevailed for decades. Then, registered reps of broker-dealer firms started advertising themselves as providing "trusted advice" without changing their legal or business obligations. By June 2009, former SEC Chair Mary Schapiro said the broker-advisor divide was overstated and, instead, stated that the "two industries are merging to the point of, in some cases, relative indistinguishability."

Differences in broker and advisor conflicts of interest largely derive from well-established legal obligations and structural differences that define what broker–dealers and independent investment advisors do.

The Question Is for Whom the Financial Rep Works

Frankel identifies the conundrum of the different roles of broker-dealers and investment advisors.[5]

> *When broker-dealers serve as brokers as well as advisers and financial planners their legal status is increasingly ambiguous. They hold themselves out to advise clients … but view themselves as securities salespersons. (p. 48)*

Securities attorney Michael Koffler writes:

> *Broker-dealers act for their own account or as agents of the issuer, principal underwriter, syndicate members or wholesaler … and are contractually obligated … to distribute the very securities that they provide advice and recommendations on to investors.*[6]

In contrast, Koffler points out that investment advisors exist solely to provide investment advice to their clients. In describing the personal nature of the investment advisory relationship, Koffler cites the background of the Advisers Act and a key Supreme Court case (*SEC v. Capital Gains Research*): "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."[7]

The core difference is that brokers are contractually required to represent issuers or other parties while advisors are legally required to represent clients. Brokers exist and are compensated by others to sell and distribute products while advisors exist and are compensated by clients to advise clients as fiduciaries

Conflicts Are Like a Virus That Is a Mortal Threat

Carlo V. di Florio, then director of the SEC Office of Compliance, Inspections and Examinations, offered a vivid reminder of the potential lethal role of conflicts of interest. In October 2012, he spoke on "A topic of perpetual importance to all aspects of compliance and ethics programs, conflicts of interest."[8] Di Florio looked at history, ethics, and securities laws, and he offered a powerful metaphor for why conflicts are harmful.

> *[O]ne can think of ethical concepts as the white blood cells that make an organization's 'immune system' … effective. … [C]onflicts of interest can be thought of as the viruses that threaten the organization's wellbeing. As in the microbial world, these viruses … if not eliminated or neutralized, even the simplest virus is a mortal threat to the body.*

Di Florio continued, "Especially when combined with the wrong culture and incentives, conflicts of interest can do great harm."

Reg BI, Form CRS, and Advisor Guidance

The June 5, 2019, rulemaking sought to "enhance the quality and transparency" of retail investors' relationships with advisors and brokers.[9] Rules Reg BI and Form CRS were joined with new guidance on the Advisers Act.

Reg BI

Reg BI sets out what brokers should do in terms of disclosure, care, conflicts, and compliance.[10] The Reg BI release discusses whether any conflicts should be eliminated and concludes that they should not be. "We did not mandate the absolute elimination" of any "particular conflicts" because "[w]e were concerned that the absolute elimination of specified conflicts could mean a broker-dealer may not receive compensation for its services."[11] The SEC instead chose to only eliminate certain sales contests and the like, and opted to let broker-dealers determine if mitigation is needed, per SEC guidance.

Some criticized Reg BI correctly for failing to raise standards. Consumer Federation and Public Investors Arbitration Bar Association argued that the SEC's Reg BI is a step backward.[12] Research by the North American Securities Administrators Association (NASAA, the state securities regulators), revealed Reg BI failures in 2023: "Firms are still relying heavily on suitability policies and strategies that predated Reg BI. Efforts to address the standard of care concepts established by Reg BI remain perfunctory."[13]

Form CRS

Form CRS is the required two- or four-page disclosure advisors and brokers must use to describe what they do. Some language is required; other language is narrowly scripted so that the differing roles and purposes of advisors and brokers are virtually ignored. Instead, they are discussed as similar, if not indistinguishable. This is evident in the language that advisors and brokers must use to disclose their services:[14]

> *When we provide you with a recommendation as your broker-dealer, or act as your investment adviser, we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations and investment advice we provide you. Here are some examples to help you understand what this means. (p. 14)*

In addition to making advisors and brokers appear indistinguishable, SEC guidance in March 2022 warns investment advisors against citing their fiduciary status on

'WHEN WE PROVIDE YOU WITH A RECOMMENDATION AS YOUR BROKER-DEALER, OR ACT AS YOUR INVESTMENT ADVISER, WE HAVE TO ACT IN YOUR BEST INTEREST AND NOT PUT OUR INTEREST AHEAD OF YOURS.'

Form CRS because doing so may be deemed "misleading" or "extraneous" by the SEC.[15]

Advisor Guidance

Efforts to narrow advisor and broker differences are also evident in how the SEC re-interpreted the Investment Advisers Act of 1940 in Release IA-5248. This release was criticized by 12 "concerned" law professors.[16] The "Concerned 12" point out how the SEC's interpretive guidance significantly weakens the fiduciary duty to address conflicts:

> ***Although Capital Gains insists that fiduciaries have "An affirmative duty of utmost good faith and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading clients," Release 5248 largely downsizes these requirements to an obligation to disclose all material facts about conflicts.***

What is missing, according to the 12 law professors, is the well-established principle that "the investment adviser must seek to avoid conflicts of interest, not merely disclose them."

Harmonizing Sales With Advice Harms Investors

This rulemaking completes an industry-led decade-long effort to "harmonize" brokerage sales with fiduciary advice: To harmonize not by raising broker standards but by allowing advisors to lower their standards, allowing dual registrants to conflate their broker-dealer and investment-advisor hats, and allowing broker-dealers to proclaim a fiduciary-like best interest standard without showing any substantive basis that they do so.

To be clear, the SEC's objective has not been to change what brokers do but to change how investors and brokers view and think about what brokers do. Forget changing broker-dealers from sales firms to fiduciary-based advice firms. Research from the state regulators (noted above) suggests broker-dealer practices have barely changed under Reg BI. Instead, they have been rebranded through Madison Avenue messaging, so brokers can say they meet the same standard as investment advisors. Meanwhile investment advisors have been warned by SEC staff not to cite their fiduciary status in Form CRS.

This rulemaking is a momentous change. It rejects longstanding principles affirmed by the United States Supreme Court in 1963 in *SEC v. Capital Gains Research Bureau*. It rejects highlighting legal advisor-broker differences. It rejects requiring or recommending that brokers should avoid conflicts. It rejects the established legal view that conflicts of interest are inherently harmful and should be avoided. Instead, conflicts are rebranded as acceptable.

What's ahead for fiduciary advice and conduct standards for retail investors in 2025 under the new SEC?

Paul Atkins Is Slated to be the Next SEC Chair

President Donald Trump has nominated Paul Atkins to be the next SEC chair. Atkins received rave reviews from the industry.[17] Incoming Senate Banking Committee Chair Sen. Tim Scott (R-SC) said Atkins will lead the SEC out of the current SEC chair's "disastrous tenure." Meanwhile, Sen. Bill Haggerty (R-TN) stated, "Many of the financial institutions that are regulated by the SEC, I think, are going to welcome Paul's arrival like a breath of fresh air."

The Wall Street Journal supports Atkins and concluded in its editorial: "Mr. Atkins is the opposite of Mr. Gensler in temperament and regulatory ambition. That means he's exactly what the SEC needs."

Sen. Elizabeth Warren (D-MA) offered a different perspective: "The U.S. stock market is the envy of the world precisely because the SEC promotes safe and transparent markets that protect investors, so I'm concerned about putting at the helm of the SEC a Wall Street lobbyist whose main contribution during the last financial crisis was to protest fines against the giant corporations that defrauded investors."

THIS RULEMAKING COMPLETES AN INDUSTRY-LED DECADE-LONG EFFORT TO 'HARMONIZE' BROKERAGE SALES WITH FIDUCIARY ADVICE.

Atkins has a long record in the securities industry, most recently as SEC Commissioner from 2002–2008 and then founding Patomak Global Partners LLC. His reputation as a fervent advocate and defender of the industry is clear. On conduct standards, Atkins strongly supports Reg BI. Atkins's ascension to SEC chair will launch a new era of heightened deregulation. Fiduciary and best interest standards will take a back seat and investor protection will suffer.

The economic, regulatory, and policy assumptions of conservatives and libertarians differ sharply from those of consumer advocates. The key conservative principle is that less regulation is deemed better while consumer and fiduciary advocates favor reasonable regulation that protects consumers. One area where conservatives tend to be more supportive concerns the issue of disclosure.

Conclusion

The demise of fiduciary advice and rise of sales brokerage and more disclosure is the story of conduct standards at the SEC from 2009–2024, through three Democratic and one Republican administration. Thankfully, state regulators (NASAA) and the U.S. Department of Labor have disagreed and clearly understand what fiduciary duties mean and why they merit preservation.

In 2025, the new SEC, with its conservative and libertarian leanings, almost certainly will be inclined to improve disclosure rather than fiduciary guidance or enforcement. The Kleimann research demonstrates how disclosure can be improved and effective. The Kleimann research questions conventional wisdom that the main problem is that investors are "confused." This research demonstrates that confusing information and

CAN THE SEC CREATE DISCLOSURE THAT IS CLEAR, CONCISE, AND MEANINGFUL?

Research by Kleimann Communications Group, a communications research firm, suggests that SEC disclosure can be improved. Kleimann was commissioned by AARP and the CFP Board to develop and test language for the SEC's Form CRS. Findings were reported in September 2018 and December 2018. The December report used the September findings to "develop and test alternative language and design."[18] The alternative language made a difference. In the December report, clearer differences between advisors and brokers were expressed in plain language describing concrete ideas. Investor understanding improved markedly. The findings are initial and modest, but they are clear. Here are summaries of findings on four topics.

Basic Services

ADVISORS. Investment advisor and management: This is an advisory relationship.

BROKERS. Sales recommendations and trading: This is a sales relationship.

Kleimann made an important improvement by replacing the word "brokerage" with the word "sales." Participants demonstrated significantly better understanding than with the prior SEC Form CRS. Participants clearly understood advisor accounts as "advisory" and broker accounts as "sales."

Kleimann reports:

> *For the most part, across the three sites, participants could characterize the main differences between the Investment Adviser accounts and the Broker-Dealer accounts … the Broker-Dealer account was characterized as being based on a sales relationship. … Generally, participants had positive attitudes toward the Investment Adviser accounts and somewhat negative attitudes toward the Broker–Dealer accounts. (p. 34)*

The report states:

> *Participants primarily described the difference as an advising relationship with an Investment Adviser account and a sales relationship with a Broker-Dealer account. … Provided with a clear distinction between advice and sales recommendations, participants expressed a strong preference for advice. (p. 13)*

How Do You Pay for Our Services?

ADVISORS. The header is FEES and the text is, "You pay ongoing fees for advice and implementation based on a percentage of the value of the assets in your account."

BROKERS. The header is COMMISSIONS AND OTHER FEES and the text is: "You pay a commission or other sales fees for each transaction in your account."

Again, Kleimann made an important improvement by replacing the term "transaction-based" with the word "commission."

The report states:

> *With few exceptions, participants understood the basic pay structure of a percentage based on the total assets under management … or a commission based on each transaction completed for the Broker-Dealer accounts. Yet, most participants raised questions about "additional fees" and were bothered "since these fees were neither defined nor explained in terms of when they would be charged or in effect. (p. 10)*

What Is Our Legal Obligation to You?

ADVISORS. "By law, we must follow the highest legal standard of conduct, called a fiduciary standard."

BROKERS. "By law, we must follow a best interest standard."

Again, Kleimann made an important improvement by adding the term "highest legal standard" to define "fiduciary."

The report concludes:

> *Our subject matter experts struggled the most with developing this section, and our results show that more needs to be done. Across the three sites, participants responded positively and strongly to the use of the phrases 'highest legal standard' and 'fiduciary standard.' Although they could not define either phrase, they surmised it required a high level of conduct for Investment Adviser accounts. Most understood that the standard would apply to all advice supplied about an Investment Adviser account. …*
>
> *In contrast, participants had far more difficulty with the best interest standard. Few were able to offer a definition and nearly all perceived it as a lower standard than that of the Investment Adviser account. Most understood that the standard applied only when making sales recommendations. … there remained an undercurrent of distrust in nearly all of the statements about the Broker-Dealer accounts, especially when participants raised the underlying sales relationship. (p. 45)*

Kleimann's finding that participants could not define "best interest" is no surprise. Reg BI did not define the term and SEC commissioners noted "best interest" has no clear meaning. This matters. Kleimann noted that without clarity around basic concepts, disclosure effectiveness will be "modest."

What Is a Financial Conflict of Interest? How Do We Handle Conflicts?

ADVISORS. "Sometimes our interests conflict with yours. This means that advice that results in extra income for us is not the best for you."
BROKERS. "Sometimes our interests conflict with yours. This means a sales recommendation that results in extra income for us is not best for you."

Kleimann reports:

> ***Participants grappled with a definition of 'conflicts of interest,' although they had a vague and general intuitive sense that it would not be good for them. ... Participants at all three sites could not adequately explain what it meant to consent to a conflict ... (page 11)***

Participants' difficulty understanding the meaning of "conflicts of interest" is not surprising. Kleimann was prevented from providing a meaningful comparison between investment advisors and broker-dealers based on their differing roles, core businesses, and differing fiduciary duties. Participants were not told that advisors have a legal duty to do what's best for clients to avoid conflicts. To the contrary, a broker-dealer has a legal obligation or financial incentive to not avoid conflicts.

In summary: Yes, creating clear, concise, and meaningful disclosure is possible.

Kleimann shows that better disclosure can be made–if there is clarity around what's to be disclosed.

Kleimann explains that crafting meaningful disclosure when there is a "fundamental lack of clarity around key ideas" is hard. "Best interest," "consent," and "mitigate" are noted as lacking definition or not being understood.

The report states:

> ***We, our subject matter experts, and our participants struggled with understanding and expressing these ideas cogently and explicitly. The key point? [C]lear writing is rooted in clear thinking. Without such efforts at a policy level, our results ... will be modest. (page 64)***

The report demonstrates the positive impact of using plain language to describe concrete ideas. This is evident on the topics of "basic services," "how brokers and advisers are paid," and "legal obligations."

Kleimann revised or replaced words or terms that in prior testing caused confusion among investors. The word "fiduciary" was defined as the "highest legal standard." "Transaction-based fee" was replaced by "commission" and "brokerage" was replaced by "sales" to describe the basic broker-dealer account. In each instance Kleimann reported improved investor understanding of the concepts being described.

messages play a significant role. The best possible disclosure will never substitute for or replace enforced real fiduciary duties, but better disclosure that is clear, concise, and meaningful can help investors make choices that better serve their interests.

Knut A. Rostad is president and founder of the Institute for the Fiduciary Standard, a nonprofit organization that exists to advance the fiduciary standard through research, education, and advocacy. For more information, see www.thefiduciaryinstitute.org.

ENDNOTES

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