ON THE FIDUCIARY DUTIES OF REGISTERED INVESTMENT ADVISERS:

HOW DID WE GET TO TODAY? & RECENT DEVELOPMENTS

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Why This Session, Why Now

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- A fiduciary duty is an enforceable legal standard — not a compliance checkbox or a marketing slogan
- 2025–2026: the most active period for fiduciary law developments in a decade
  - DOL's 401(k) prudence proposal
  - SCOTUS pleading fight
  - *Cunningham*
  - market confusion over "fiduciary"

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Session Roadmap

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- Part 1 — A Consolidated History of RIAs and Fiduciary
- Part 2 — Refresher: duty of care, duty of loyalty, no-conflict/no-profit, the four-part defense for breach of fiduciary duty
- Part 3 — Language: the SEC's history with "fiduciary," fee-only
- Part 4 — Enforcement reality: share classes, dual registration, due diligence
- Part 5 — Key Developments Over the Past Year

Recommendations and Observations

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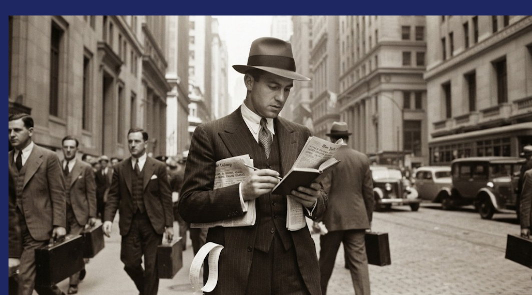
PART 1

From 1930's to Today

A CONSOLIDATED HISTORY



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1930's to 1940

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- 1934 Securities Exchange Act of 1934 – *registration* of brokers and dealers in securities
- 1937 Maloney Act – amended 1934 act to create BD self-regulatory organizations (regional contemplated – only NASD, now renamed FINRA – emerged in 1940)
- Investment Company Act of 1940
- Investment Advisers Act of 1940

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Investment Advisers Act of 1940

Captures individuals or firms who cross the boundary into charging **distinct, specialized fees** (such as wrap fees or advisory percentages) for **financial guidance**, thus triggering a distinct **fiduciary duty** that does not exist under standard 1934 Act brokerage transactions

- Initially required only **registration** of Investment Advisers, not books and records
  - Broker-dealers and their registered representatives exempted from registration under IAA of 1940 if not receiving "**special compensation**" and advice was "**solely incidental**" to the transaction
- **1960 Amendments:** power to require advisers to keep accurate books and records, power to inspect, power to terminate registration of investment adviser if violate

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SEC vs. Capital Gains (1963): OFTEN MISCONSTRUED

- U.S. Supreme Court ***confirmed*** long-standing view that Section 206 of IAA imposes a fiduciary duty on investment advisers
  - **Fiduciary status for RIAs and Some BDs Was Well-known in 1940s:** For example, Louis Loss, General Counsel of the SEC, in 1948 speech: "it is necessary to decide whether a firm is acting in a particular transaction as a dealer pure and simple or as a fiduciary … **depends not so much on any magic words but upon all of the surrounding circumstances, including the degree of sophistication of the parties and the course of conduct between them … The law must operate on the habits of people and the way most of us do business**."
- CAN BROKERS BE FIDUCIARIES? SEC in 1963 Special Study: "where a **relationship of trust and confidence** has been developed between a **broker-dealer** and **his customer** so that the customer relies on his advice, **a fiduciary relationship exists**"

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The Language Securities Law Attorneys Tend to Skip

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- **If conflict of interest exists, what is required under *SEC vs. Capital Gains*?**
  - **Disclosure** was the remedy that fit the specific facts - undisclosed scalping (purchasing securities as dealer at low value, reselling to customers)
    - Often cited today for a broader **"disclosure equals compliance"** rule the holding does NOT actually establish
    - Disclosure NOT framed as a universal safe harbor for every future conflict
  - **The Overlooked Language:**
    - "[I]t was argued by 'some investment counsel representatives' who testified before the Commission - that any 'trading by investment counselors for their own account in securities in which their clients were interested …' **creates a potential conflict of interest which must be eliminated**. **We need not go that far in this case, since here the Commission seeks only disclosure of a conflict of interests"**

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SEC vs. Capital Gains (1963)

- "The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his **advice be disinterested**"
- "[T]wo fundamental principles upon which the pioneers in this **new profession** undertook to meet the growing need for unbiased investment information and guidance were, first, that **they would limit their efforts and activities to the study of investment problems from the investor's standpoint**, **not engaging in any other activity, such as security selling or brokerage**, which might **directly or indirectly bias their investment judgment**; and, second, that their remuneration for this work would consist solely of definite, professional fees fully disclosed in advance … Although certain changes were made in the bill following the hearings, there is nothing to indicate an intent to alter the fundamental purposes of the legislation."

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NASD's "Greatest Accomplishment" (Late 1940's)

- Preventing **brokerage activities** (i.e., acting as agent for a customer)

  From Being Separated From

- **Dealer activities** (sale of securities from inventory – principal transactions; and IPOs)

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SEC Warns BDs to Not Obscure What They Do

The SEC's 1963 Special Study of the Securities Markets: Dual Registrants

"The **combination of advisory and sales** functions within broker-dealer firms creates 'built-in' conflicts of interest that endanger investors. When a customer ***relies on the advice of a salesperson***, the salesperson 'in effect **becomes an investment adviser**, and some aspects of a **fiduciary relationship** arise between the salesman and the customer.'"

EXEMPTION from REGISTRATION as RIA does NOT mean that fiduciary duties never apply

"[BD 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"**

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MERRILL LYNCH RULE (1999—2007)

Created a "broker-dealer exception" allowing brokerage firms to charge fee-based (asset-under-management) compensation on brokerage accounts without those accounts, or the reps servicing them, being regulated as investment advisers under the Advisers Act, if the advice was "solely incidental"

Many BDs adopted fee-based accounts.

Very common … 3% annual fee

2003-5: I advocated that two different standards existed for same conduct:

SEC's *non-fiduciary* standard for BDs

IAA's *fiduciary* standard for RIAs

SEC's Final Rule (2005) was overturned in 2007:

Financial Planning Association vs. SEC. ("special compensation" existed)

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Great Financial Crisis Leads to 2010 Dodd-Frank Act

Authorized SEC to impose fiduciary duties upon BDs

(Never done)

Study of financial planning authorized

(Conclusion: no regulation needed)

Study of BD/RIAs undertaken by SEC / RAND Corporation:

Ron observes: 30% of clients of BDs/RIAs thought they paid no fees

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DOL: THE "SHERIFF" (Phyllis Borzi: 2009-2017 tenure)

- **Disclosures mandated to plan sponsors**
- **Disclosures mandated to plan participants**
- **Attempts to impose *fiduciary duties* on ALL advice to plan sponsors / participants, and on IRA rollovers**
  - **MANY court cases upheld the final rules, BUT the 5th Circuit (very conservative) OVERTURNED rule proposals**

STILL IN EFFECT: any adviser who already has fiduciary status to the plan or IRA on other grounds must still comply with PTE 2020-02 when making rollover recommendations

AND, per SEC: April 2022 Staff Bulletin (Standards of Conduct for Broker-Dealers and Investment Advisers (comparison of costs and fees, level and quality of services in the existing plan/account versus the proposed IRA or new account, available investment options, penalty-free withdrawal features, required minimum distribution treatment, creditor/asset protection differences, and employer stock considerations (net unrealized appreciation) where relevant — layered onto the standard "know your customer" profile (financial situation, time horizon, liquidity needs, risk tolerance, sophistication, goals) (IN WRITING)

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Reg BI and Form CRS: TRAVESTIES from the SEC

REGULATION "BEST INTEREST": SEC approves of misrepresentations and re-defines the English language

Formulated by BD lobbying groups; endorsed by FINRA

"BEST INTERESTS" was for two centuries the explanation of a fiduciary's duty of loyalty – in a very large number of court cases

NOT a fiduciary standard. DOES impose duty of care, BUT not duty of loyalty.

Form CRS: fails to distinguish adequately between BDs (product salespeople) and RIAs (fiduciary advisors)

December 2021 staff statement on Form CRS disclosures: firms are required to use the prescribed language in that item — the standardized "best interest"-anchored phrasing set out in the form's instructions — precisely so that a retail investor can compare a broker-dealer's summary against an adviser's summary using consistent terms; **the instructions "do not permit firms to state their required standard of conduct using their own wording," fiduciary included**.

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Observations: Self-Regulatory Organizations

FINRA: The Worst Regulator in the World?

- Failure to raise standards to "highest" (Maloney Act aspirations)
- Failure to advise BDs that they can be fiduciaries (consistently)
- Falsely opined to SEC that brokers act in "best interests" of customers
- Changed its name to attempt to regulate investment advisers
  - (Per my conversation with FINRA insider; denied by FINRA)
  - 2012-3 attempt to add RIAs thwarted

- FINRA's investigatory / prosecutorial / adjudicatory bundle of powers, exercised by a private SRO, may violate the **private nondelegation doctrine** of Article II of U.S. Constitution
  - Judge Walker, concurring opinion (2024)
  - *No ruling on the merits of this issue - yet*

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Observations: Self-Regulatory Organizations

Investment Adviser Self-Regulatory Organization?

- **The SEC in 1963** wrote: [R]egistered investment advisers other than broker-dealers, should be organized into an official self-regulatory association or associations, which should then adopt and enforce substantive rules"
- SEC's 2011 Dodd-Frank Section 914 study: (1) more SEC examiners; (2) RIAs under FINRA; (3) new SRO for advisors
- **More likely:**
  - **Raising threshold for SEC registration: $100m (2010) to … $1 billion?**
    - **No active rule proposal … but: "small entity" definition (2026 proposal)**

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PART 2

Fiduciary Duty Refresher

Care, loyalty, the no-conflict / no-profit rules, and the defense to breach

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What Is a Fiduciary Duty? (Refresher)

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- Imposed by the Investment Advisers Act §206(1)–(2), built on common-law trust and agency principles
- Two core components: the **duty of care** and the **duty of loyalty**
- A **status-based duty** — it attaches from the relationship itself, not from contract language
- **Cannot be fully contracted away**, though its **scope** can be shaped by the engagement
  - Cannot be (wholly) **waived**
  - very, very limited application of ***estoppel***

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The Duty of Loyalty: Three Components

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1. No Conflict: don't place your own interest against the client's — absent proper handling

2. No Profit: don't profit from the fiduciary position, or from information gained through it

3. Undivided loyalty: don't favor one client over another

- Origins in classical trust and agency law, carried into the Advisers Act's antifraud provisions
- **A conflict of interest — or additional profit — is itself a breach of duty**
  - Intent to harm is not required
  - Burden of proving fairness shifts to the fiduciary

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The Defense to a Loyalty Breach: A Four-Part Test

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- **1. Full and fair disclosure of the conflict**
- **2. The client's actual understanding of what was disclosed**
- **3. Informed consent — a genuine, knowing choice to proceed**
- **4. Substantive fairness — the recommendation is, in fact, in the client's best interest – *substantively fair to the client***

All four are required.

Missing any one of the four leaves the conflict of interest not managed properly.

Why This Is a Genuinely Tough Test

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- **Conflicts of interest are structurally embedded in financial services**
  - Greater (differential) compensation nearly always results from higher fees/costs in the product or greater risks to the client (such as in FIAs from insurance companies with low financial strength ratings)
    - **Greater compensation = higher fees/costs = lower returns to investors**
      - Compared to substantially similar investment securities / products
- Satisfying all four elements, every time, for every conflicted recommendation, is ***operationally difficult but legally required !!!***
- Result: many industry conflicts are disclosed — but not properly managed under the full test

Disclosure Failures Are Easy to Enforce —
BUT: Care Failures Are Not Easy to Enforce (By Examiners)

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- Failure to disclose: a binary, documentable fact — visible from a file review
- Informed consent:
  - fact-intensive, judgment-laden
  - hard to detect and prove (“battle of the experts”)
- Substantive fairness to the client
  - Tests the “informed consent”; also difficulty to prove
- **Result: enforcement gravitates to the disclosure violation — not necessarily the more serious harm**

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PART 3

Language and Marketing

The SEC's fraught history with "fiduciary," its overuse, and fee-only vs. fee-based

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The SEC's Uneasy History With the Word "Fiduciary"

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- SEC's 2019 package created "best interest" (Reg BI) for broker-dealers — deliberately not "fiduciary"
  - Permits ongoing portfolio management
  - Are 12b-1 fees *AUM Fees in Drag?*
    12b-1 fees on the decline - shift to advisory accounts & ETFs
    Possible repeal within next decade or so
- Result: the same client can face two different legal standards without a reliable way to tell which applies
  - *The Market for Lemons* returned under Reg BI

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The Overuse of "Fiduciary" in the Marketplace

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- "Fiduciary" has become a **marketing word** — used even by dual registrants with unmanaged conflicts
- Claiming fiduciary status is not the same as satisfying fiduciary duty on every recommendation
- Dual registrants switch "hats" across accounts and products — often without flagging which hat is on

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Fee-Only vs. Fee-Based: Why the Distinction Matters

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- **Fee-Only:** compensation from client-paid fees only — no commissions, no revenue sharing
- **Fee-Based:** a mix of client fees and commissions or other third-party compensation
  - "Fee-based," describing a person or firm, is inherently misleading
    - *Should be:* “fee-and-commission based” or “commission-and-fee based”
  - HOWEVER - it is acceptable to describe a specific account type as “fee-based”

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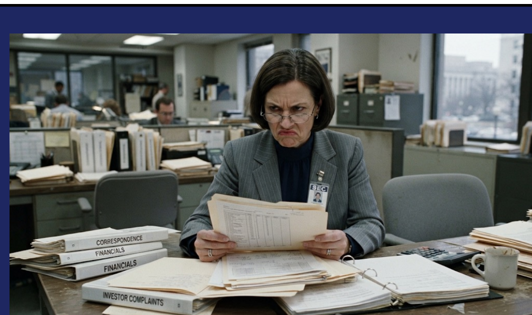
PART 4

Enforcement Reality



Share classes, compensation conflicts, the dual-registrant dilemma, and due diligence

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SEC Enforcement Reality: Share Classes & Compensation Conflicts

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- **Share Class Selection Disclosure Initiative:** over $125 million returned to clients
  - Dual registrants recommend, in advisory accounts, shares with 12b-1 fees vs. shares without 12b-1 fees
- **FY2025: undisclosed compensation, revenue sharing, and fee-offset failures** — penalties from ~$150K to $45M
  - A consistent enforcement category across administrations

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The Dual-Registrant Dilemma: Choice of Account

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- Advisory (fee) vs. brokerage (commission) — the account-type choice is itself a conflict
  - SEC has specifically targeted undisclosed incentives behind advisory/brokerage conversions
  - The exam question: is the account type chosen for the client — or for the adviser's compensation?
- ***It is tough to be a dual registrant !!!***

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Due Diligence Principles for Investment Recommendations

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- Understand the investment: structure, strategy, risk, cost, expected behavior
- Compare against a reasonable number of alternatives — risk-, cost-, and liquidity-adjusted
- Confirm suitability for THIS client's objectives, horizon, and risk tolerance — not for a model client
- Document the process and monitor on an ongoing basis (duty is continuing if Prudent Investor Rule applies — *Tibble v. Edison*)

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Heightened Due Diligence: Alternative Investments

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- Illiquidity — redemption gates, lock-ups, secondary-market discounts
- Valuation opacity — infrequent, manager-marked, "smoothed" pricing
- Complexity — may exceed the adviser's own expertise
- Benchmarking difficulty — no clean public-market comparator

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PART 5

2025–2026 Legal Update

The DOL's proposed rule, the substantive due diligence gap, and Anderson v. Intel

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2026 DOL Proposed Rule: A Six-Factor Prudence Safe Harbor

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- Proposed March 2026; 60-day comment period
- ***Process-based*** safe harbor: adequately considering six factors earns a presumption of reasonableness
- The six factors: performance, fees, liquidity, valuation, benchmark, complexity
- Limits: addresses selection only — not the ongoing duty to monitor (Tibble); excludes brokerage windows
- Disregards *duty to avoid waste of assets* under Prudent Investor Rule
  - **Seeks to justify Wall Street's extraction of higher fees from complex alternative investments that – at best – have a mixed history of producing higher returns than publicly traded securities**

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Why a Six-Factor Checklist Is Not Substantive Due Diligence

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- Proceeds "in lieu of" the 1979 rule "and act accordingly" language — where **substantive prudence** resides
  - **Procedural due care (followed the steps?) ≠ substantive due care (was the decision actually sound?)**
- **Diversification:** a single private fund often concentrates capital in a few dozen holdings
- **Dispersion:** private-fund IRRs ranged roughly -10% to +23% (5th–95th %ile) vs. ~6.6%–10.3% for comparable public funds
- "A meticulously papered file is not a safe harbor" where the **process is blind to structural flaws**
- **"Risk-adjusted returns" – is this criteria valid, given low volatility anomaly?**

How Easy Is It to Sue Plan Sponsors?
Anderson v. Intel: SCOTUS and the "Meaningful Benchmark"

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- 9th Circuit: plaintiffs must plead a "meaningful benchmark" to state a prudence claim
- Supreme Court will hear oral arguments: October 6, 2026
  - *Must a plaintiff alleging an ERISA breach of fiduciary duty due to fund underperformance plead a "meaningful benchmark" (a direct comparator fund) to survive a motion to dismiss?*
  - If "YES": a strong early-dismissal tool for plan fiduciaries
  - If "NO": benchmarking bar drops — allocations to alternative investments become easier to challenge
- Either way: a pleading rule does not settle what discharges the duty on the merits

When Both Broker and Adviser: *Cutter* (2026) Fiduciary Duties Extend to Entirety of the Relationship

(*SEC v. Cutter Financial Group*): In *SEC v. Cutter Financial Group* a federal court held that Section 206 reaches an investment advisor's recommendations to liquidate advisory assets to buy non-security insurance products (fixed index annuities). The court rejected the defense that insurance sales are "divorced" from advisory fiduciary status, confirming that advice concerning an overall portfolio remains subject to Section 206

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Other Notable Developments Worth Tracking

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- **SEC: AI-washing enforcement actions** — false or exaggerated claims about automated investment capabilities
- **SEC: Continued Marketing Rule enforcement** — performance claims, undisclosed endorsements
- **SEC: Renewed skepticism toward hedge clauses limiting fiduciary liability by contract**
- **State-level "best interest" standards for annuity sales** — a growing patchwork
  - NAIC model rule: "Compensation" is "not" a conflict of interest !!!!

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Practical Takeaways

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- **CONFLICT OF INTEREST:** ***disclosure is necessary but never sufficient*** — the four-part test is the real compliance standard: DISCLOSURE + CLIENT UNDERSTANDING + INFORMED CONSENT + TRANSACTION SUBSTANTIVELY FAIR TO CLIENT
- **Audit your own language:** "fiduciary," "fee-based," and account-type descriptions should be defensible
- **Build a documented alternatives due-diligence process** — DOL rule likely establishes a floor, not a ceiling, on the judgment required in establishing the process and in applying the process; PRUDENT INVESTOR RULE controls
- **Due Diligence Memorandum:** written documentation justifying your investment strategy and investment security selection
  - **Don't overly rely on your own firm's due diligence**
  - Why you use certain asset classes; why you don't use others
  - Comparison of funds / ETFs / CITs, other pooled investment products

CONCLUDING THOUGHTS

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- **Artificial intelligence IMPACT on RIAs and financial planning**
  - Become the *expert* and advisor to HNW / complex situations
- **Invest in yourself … continued education**
  - Financial advisors: Nerd's Eye View (blog, podcasts)
  - Tax-related webinars
  - Investment strategies and products
    - Better CE needed in these areas
- **Be wary …**
  - Variable annuities
  - Fixed indexed annuities (lower cost alternatives / similar strategies)
  - Private equity (wide dispersion of returns; lack of sufficient historical data)
  - Private credit (risky; duplicate/diversify via low-cost high-yield bond funds)
  - 12b-1 fees (eventually, repealed; conflicts of interest)
  - Dual registration (20/20 hindsight by regulators)

CONCLUDING THOUGHTS

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- **Be the TRUSTED ADVISOR**
  - Duty of Care — Expert
  - Duty of Loyalty — Avoid Conflicts of Interest
  - Duty of Utmost Good Faith — Candor, Honesty
- **Advocate for the *Profession* of Financial & Investment Advice**
  - Bona fide fiduciary duty applies
    - Support the Institute for the Fiduciary Standard
    - Educate federal, state legislatures
- **If Not Already … Become Fee-Only**
  - Join and support NAPFA
- **Advocate Before CFP Board**
  - 1) Will 4-Year Degree Still Be Required to Become a CFP?
  - 2) Ron's View: CFP Board Should Abandon "Compensation Neutral" stance

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