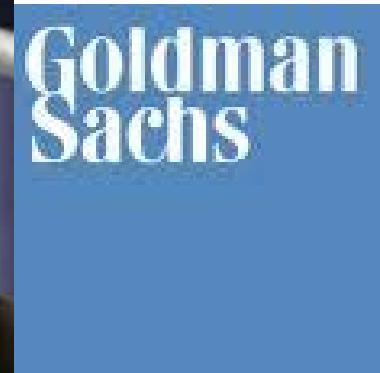


Harmonizing the Regulation of Financial Advisors

May 3, 2012

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New Legislative Reforms



- Consumer Financial Protection Agency
- Regulation of derivatives
- Regulation of executive compensation
- Systemic regulator to manage risk
- Mandatory registration of hedge fund advisers
- Council of regulators
- Heightened consolidated supervision
- *Enhancing investor protection*

Proposal to Enhance Investor Protection



- Harmonize the law regulating broker-dealers and investment advisers
- Impose a fiduciary duty on brokers who give advice to retail customers

Brokers-Dealers v. Investment Advisers

- Broker-dealers – dual role
 - Brokers: execute transactions *for* their customers
 - Dealers: execute transactions *with* their customers
 - Provide advice on what securities to buy and sell
 - Charge commissions



Brokers-Dealers v. Investment Advisers

- Advisers
 - Provide advice
 - Asset allocation
 - Portfolio management
 - No execution (use BD)
 - Restrictions on “dealing”
 - Charge asset-based fees

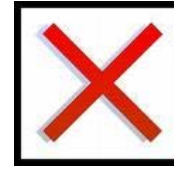




Federal Regulation

- Broker-dealers
 - Securities Exchange Act of 1934
 - No uniform fiduciary duty to act in customer's best interest – “suitability” standard
- Investment advisers
 - Investment Advisers Act of 1940
 - Strong federal fiduciary duty to act in client's best interest

Broker-Dealer Exclusion



- BDs are excluded from IAA under two conditions
 - Advice is “solely incidental” to brokerage
 - Do not charge “special compensation” for advice
- Separation of brokers and advisers worked well
 - Differentiated by compensation
 - Brokers subject to EA and SRO rules under suitability standard
 - Advisers subject to IAA under fiduciary standard
 - Dual registrants: account-by-account regulation

Changes in the Industry

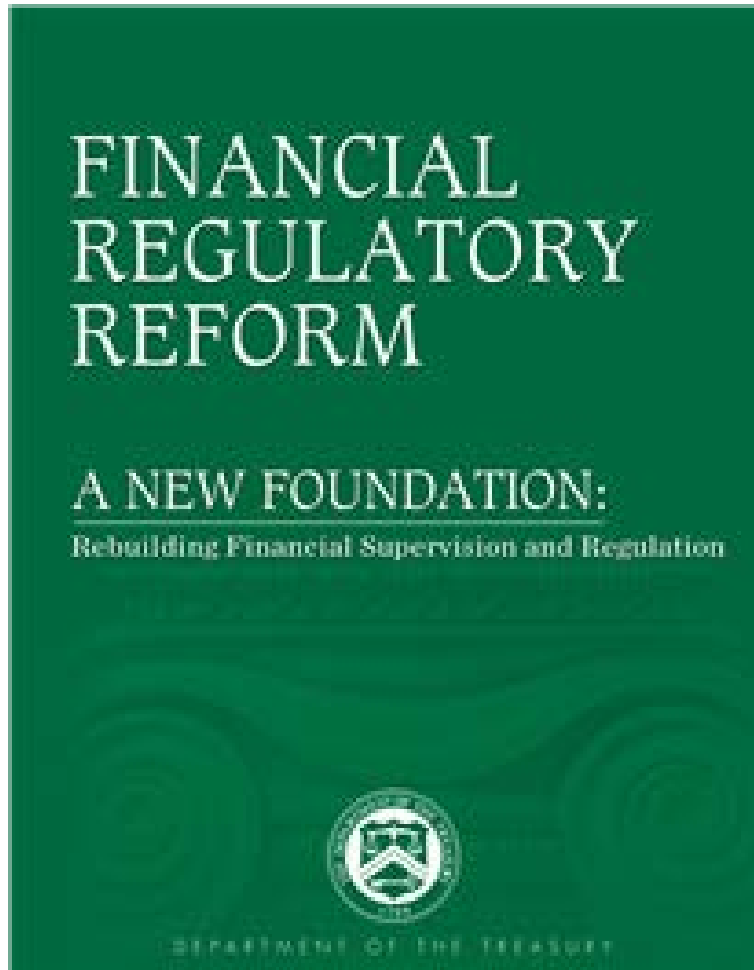
- May 1, 1975. Elimination of fixed commissions
- Led to advent of discount brokerage
 - Resulted in two-tier pricing – difference in fees may be attributable to advice
 - Resulted in migration to fee-based accounts
- Changes could be *special compensation* abrogating broker-dealer exclusion
- Technology: brokerage commoditized; advice more important relative to execution

SEC Exemptive Rule

- Broker exclusion from IAA in jeopardy
- Brokers did not want to be subject to IAA
- Sought an exemption from SEC
- SEC complied in 2005: Certain
BDs Not Deemed IAs
- Brokers would not be considered IAs
regardless of compensation charged
- Challenged by FPA – FPA prevailed in 2007



Obama White Paper



- “From the vantage point of the retail customer, an investment adviser and a broker-dealer appear in all respects identical.”
- Legislation should:
 - harmonize the standards
 - impose fiduciary duty on brokers

Dodd-Frank Act

- Dodd-Frank
 - Required SEC to conduct study on regulatory standards imposed on brokers and advisers
 - Provided rulemaking authority to harmonize duties of brokers and advisers
- SEC Study – January 2011
 - SEC pushed project off on SEC staff
 - Concluded SEC should write rules to harmonize duties of brokers and advisers
 - Hot potato: Congress to SEC to Staff, back to SEC



Recent Developments: Cost-Benefit Analysis



- Commissioners Casey and Paredes criticized study for lack of CBA
- April 2011 – views were validated by *Business Roundtable v. SEC*, overturning proxy access
- SEC Chairman Mary Schapiro announced the staff is preparing a public request for additional data on costs and benefits

Recent Developments: Retirement Plan Advisers



- DOL has overlapping jurisdiction with SEC as regulator of advice to plans and participants
- DOL is attempting to redefine when a service provider becomes a fiduciary
- New definition could cover many brokers and advisers under SEC's jurisdiction
- Different philosophies: SEC focuses on disclosure; DOL on prohibitions

Recent Developments:

SRO for Advisers



- FINRA acts as an SRO for broker-dealers, not investment advisers
- Many calls for an SRO for advisers over the years – true again today
- Disagreement over both the merits of an SRO for advisers and who it should be
- Important for harmonization: If FINRA is SRO for advisers, FINRA will help administer the fiduciary standard

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