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THE NEW FIDUCIARY STANDARD FOR BROKER-DEALERS

The Department of Labor adopted a fiduciary rule that applies to broker-dealers who conduct business with retail retirement accounts. The new rule has only been partially implemented and remains subject to challenges. However, the rule has shifted the paradigm for discussion of the proper standards that should be employed by broker-dealers.

By Hillel T. Cohn *

In April 2016, the United States Department of Labor (DOL) adopted a rule (the "Fiduciary Rule") that greatly expanded the scope of persons who would be deemed "fiduciaries" when giving investment advice to an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA) or to individual retirement accounts under the Internal Revenue Code. Born in controversy, the Fiduciary Rule survived numerous judicial challenges, but is currently undergoing a presidentially mandated re-evaluation and could be effectively repealed through proposed legislation pending in Congress. Although its future remains unclear, the Fiduciary Rule has changed the way the securities industry, regulators, and the investing public view the standard of conduct that should be employed by broker-dealers when dealing with retail accounts.

This article will briefly discuss the history of the Fiduciary Rule, describe its key features, and propose a way forward with a view to preserving the principles underlying the Fiduciary Rule while alleviating its most problematic consequences. Although the Fiduciary Rule will affect a broad swathe of the financial services universe, this article will only discuss its implications for broker-dealers.

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HISTORY OF THE FIDUCIARY RULE

For many decades, broker-dealers and investment advisers were held to different standards of conduct reflecting the significant differences in the services they provided. Investment advisers were viewed as trusted counsellors, who would provide impartial advice on purchasing and selling securities and other investments. As the U.S. Supreme Court stated with regard to the Investment Advisers Act of 1940 ("Advisers Act"): "The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested."[1] This concept is supported by Section 206(3) of the Advisers Act, which prohibits investment advisers from engaging in transactions with their clients if the adviser has a conflict of interest, absent disclosure and written consent of the client. The fees charged by investment advisers are typically calculated as a percentage of assets under management or, for some wealthier clients, a percentage of the client's gains, thereby eliminating potential tension between the client's interests and the manner in which the investment adviser is compensated.

[1] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963).