Catholic University Law Review

Volume 66
Issue 1 *Fall 2016*

Article 11

1-17-2017

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Cover Page Footnote

J.D. Candidate, May 2017, The Catholic University of America, Columbus School of Law; B.A. 2009, Duke University. The author would like to extend her deep gratitude to Professor John Leary for his expertise, guidance, and endless patience throughout the writing process, as well as to Professor Roger Hartley for his continuous help and encouragement. The author would also like to thank her family, her friends, and the editors and staff members of the *Catholic University Law Review* for their patience and support during the writing and editing process of this Note.

THE POTENTIAL EFFECT OF THE DEPARTMENT OF LABOR'S NEW FIDUCIARY RULE ON BROKER-DEALERS AND THE MIDDLE INCOME RETIREMENT INVESTORS WHO RELY ON THEM

Nadia Yoon[+]

Investment portfolios have become an essential part of retirement planning.[1] Given the complexities of the investment industry, seeking an expert's advice makes perfect business sense. With any commercial transaction, it should not be a surprise that the average customer reasonably expects (and assumes) the retail vendor to do his best to comply with state and federal regulations and not cheat his customers out of their hard-earned money.[2] The same expectation should translate to the world of retirement investments, but that is not always the case.

This expectation of contract law's "duty of good faith and fair dealing"[3] is similar to what the investment world calls the "fiduciary duty." Generally speaking, a fiduciary is "someone who is required to act for the benefit of another person on all matters within the scope of their relationship."[4] A middle income retail investor is not likely to worry about whether the person from whom she seeks investment advice is a fiduciary. After all, there are more immediate concerns on her mind, such as cost of the advice, risks involved with the investment choice, and the reputation of the adviser.[5]

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1. *How to build a diversified income plan*, FIDELITY VIEWPOINTS (Apr. 6, 2016), https://www.fidelity.com/viewpoints/retirement/retirement-income-strategies.

2. *See generally* CAROLYN L. CARTER, NAT'L CONSUMER LAW CTR., INC., CONSUMER PROTECTION IN THE STATES: A 50-STATE REPORT ON UNFAIR AND DECEPTIVE ACTS AND PRACTICES STATUTES (2009), https://www.nclc.org/images/pdf/car_sales/UDAP_Report_Feb09.pdf (analyzing and evaluating the strengths and weaknesses of consumer protection statutes in all fifty states and the District of Columbia).

3. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981) ("Good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."); *see also* U.C.C. § 2-103 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

4. *Fiduciary*, BLACK'S LAW DICTIONARY (10th ed. 2014).

5. *Fee vs. Commission: No Doubt Which Investors Prefer*, INVESTMENTNEWS (June 8, 2011, 12:01 AM), http://www.investmentnews.com/article/20110608/FREE/110609950/fee-vs-commission-no-doubt-which-investors-prefer.

The complexities of entering this field as an investor begin with how to choose the right adviser. Should the investor seek the advice of a registered investment adviser (RIA) or of a broker-dealer (BD)?[6] Although the definitions of these two terms appear to be sufficiently clear, in practical terms, the line that used to separate the two is now very blurry.[7] Their functions today are so similar that it seems the only clear difference between a RIA and a BD is their respective U.S. Securities and Exchange Commission (SEC) registration status.[8]

One would expect that without an understanding of the difference, most middle-income investors would seek the advice of whoever could give her the best value for her money. In the end, many passive retail investors prefer BDs because of the lower fees; with BDs they are still receiving investment advice, but for less money upfront. [9] However, legally, the difference between these two types of advisers is absolutely critical.[10] Under legal standards, the RIA has an obligation to act in the best interest of his clients,[11] while the BD does not.[12] If the RIA does not act in the client's best interest, he may be liable for hefty fines and even criminal penalties.[13] The BD may be liable for hefty fines as well,[14]

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6. *See* Zaw Thiha Tun, *Investment Advisor Versus Broker: How They Compare*, INVESTOPEDIA (July 15, 2015, 9:01 AM), http://www.investopedia.com/articles/investing/071515/investment-advisor-versus-broker-how-they-compare.asp (explaining the differences and similarities between investment advisers and broker-dealers).

7. SECS. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 11 (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf ("[T]his wide spectrum of services and products provided by broker-dealers may or may not involve the provision of personalized investment advice or recommendations about securities to retail customers."); *Investment Advisers and Broker-Dealers*, RAND INST. FOR CIVIL JUSTICE (2008), http://www.rand.org/content/dam/rand/pubs/research_briefs/2008/RAND_RB9337.pdf (noting that research found that one factor attributing to the lack of understanding as to the differences between registered investment advisers and broker-dealers is the usage of various types of titles, including generic titles).

8. *See* SECS. & EXCH. COMM'N, *supra* note 7, at iii–iv.

9. *Fee vs. Commission: No Doubt Which Investors Prefer*, *supra* note 5.

10. An RIA must comply with both SEC laws and regulations and ERISA, while a BD is subject to the SEC's anti-fraud regulations and FINRA's rules. David C. Kaleda, *What it Means to be an ERISA Fiduciary: A Comparison to the Securities Laws*, NAT'L SOC'Y COMPLIANCE PROF'LS, 10–12 (May/June 2013), http://www.groom.com/media/publication/1269_ERISA_Fiduciary_Comparison_to_Securities_Laws.pdf.

11. SEC v. Tambone, 550 F.3d 106, 146 (1st Cir. 2008) (noting that investment advisers have a fiduciary duty, so they must act in the best interest of their clients at all times), *vacated*, 573 F.3d 54 (1st Cir. 2009).

12. Dave Michaels, *SEC Joins Battle on Broker Bias That Could Remake Industry*, BLOOMBERG BUSINESS (Mar. 17, 2015, 5:01 PM), http://www.bloomberg.com/news/articles/2015-03-17/sec-will-develop-fiduciary-duty-rule-for-brokers-white-says ("Under current regulations, brokers must make 'suitable' recommendations, meaning the investments have to fit the customer's needs and tolerance for risk.").

13. *See* 29 U.S.C. § 1132(g), (i) (2012).

14. *See, e.g.*, FIN. INDUS. REGULATORY AUTH., DISCIPLINARY AND OTHER FINRA ACTIONS (July 2015), https://www.finra.org/sites/default/files/publication_file/July_2015_Disciplinary_

but is able to defend against such claims by showing that the investment advice rendered was suitable to the client's interests, though not necessarily in her interest.[15] The RIA must disclose information that may affect his impartial advice.[16] The BD, however, does not have this obligation, making way for more opportunities to bury hidden fees and misleading or fraudulent fine print.[17]

The repercussions of choosing the wrong adviser can be significant.[18] It is estimated that, collectively, individual retirement account investors lose about $17 billion annually from their investments due to BD misconduct.[19] Yet, there are no parallel consumer protection measures in everyday commerce that would protect the average retirement investor from activities by her adviser, especially if the adviser were to mislead the investor for the adviser's own benefit.[20] The laws intended to regulate these conflicts of interests were inadequate because they remained unchanged for forty years.[21] This is the reason the U.S. Department of Labor (DOL) announced a proposed rule on April 20, 2015 aimed

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Actions.pdf (reporting sanctions and fines imposed on firms and individuals who were found to be in violation of FINRA rules).

15. Tyler Nunnally, *What Do Tougher FINRA Suitability Standards Mean for You?*, THINKADVISOR (June 11, 2015), http://www.thinkadvisor.com/2015/06/11/what-do-tougher-finra-suitability-standards-mean-f ("If you want to steer clear of suitability violations, then it is imperative that your investment recommendations meet your client's attitude to risk. This is where having an accurate measure of your client's risk tolerance is of the utmost importance.").

16. *Information for Newly-Registered Investment Advisers*, SECS. & EXCH. COMM'N, https://www.sec.gov/divisions/investment/advoverview.htm (last updated Nov. 23, 2010) ("[Investment advisers] must employ reasonable care to avoid misleading clients and [] must provide full and fair disclosure of all material facts to [] clients and prospective clients." (alteration in original)).

17. *See Restricting Access to Financial Advice: Hearing Before the Subcomm. on Health, Emp't, Labor & Pensions of the H. Comm. on Educ. and the Workforce*, 114th Cong. (June 17, 2015) [hereinafter *Restricting Access*] (statement of Thomas E. Perez, Secretary of Labor).

18. *See* Ken Hawkins, *The Cost and Consequences of Bad Investment Advice*, INVESTOPEDIA (Sept. 7, 2014, 10:00 AM), http://www.investopedia.com/articles/pf/08/bad-investment-advice.asp; *see also* Thomas v. Metro. Life Ins. Co., 631 F.3d 1153, 1161 (10th Cir. 2011) (holding that a BD's agent did not breach his fiduciary duty to his clients when he did not disclose that he would receive an economic benefit when he rendered advice regarding a particular plan because he did not receive special compensation that was clearly attributable to the investment advice); Gregg v. Transp. Workers of Am. Int'l, 343 F.3d 833, 842, 847–48 (6th Cir. 2003) (holding that fiduciaries of an ERISA plan breached their duties when they failed to ensure the impartiality of the expert who gave advice for the retirement plan, causing the plan to sign a group healthcare policy that resulted in substantial loss for the plan).

19. *See Restricting Access*, *supra* note 17.

20. *See generally Retail Law*, HG.ORG LEGAL RESOURCES, https://www.hg.org/retail-law.html (last visited Aug. 30, 2016) (describing and listing the laws, regulations, and industry-side regulations that govern retail and consumer law); *see also Ponzi Schemes*, SECS. & EXCH. COMM'N, https://www.sec.gov/answers/ponzi.htm (last visited Aug. 28, 2016) (explaining that the best way to protect against a Ponzi scheme—a fraudulent investment scheme—is to ask questions); *SEC Enforcement Actions Against Ponzi Schemes*, SECS. & EXCH. COMM'N, https://www.sec.gov/spotlight/enf-actions-ponzi.shtml (last updated Oct. 16, 2014) (listing enforcement actions the SEC took against Ponzi schemes, which were remedial measures rather than preventative).

21. *Restricting Access*, *supra* note 17.

at increasing the reach of the definition of fiduciary status under the Employee Retirement Income Security Act of 1974 (ERISA).[22]

In February 2015, recognizing the importance of retirement investment for Americans as part of his middle-class economics focus,[23] President Obama directed the DOL to proceed with the introduction of a proposed fiduciary rule to tighten the regulation of professionals who provide investment advice.[24] In response, the DOL issued a revised version of a similar rule it had proposed in 2010,[25] but eventually retracted amidst industry backlash.[26] Many aspects of the 2010 proposed rule remained in the 2015 proposed rule, but the new proposal included significant edits that reflected the criticism and input the DOL received during the comment period in 2010.[27]

This time around, the DOL worked closely with other federal agencies also affected by the Dodd-Frank Wall Street Reform and Consumer Protection Act,[28] particularly the SEC and the Commodity Futures Trading Commission.[29] The revised proposal that was released in 2015 was a culmination of extensive collaborative work. After a comment period that lasted five months,[30] the DOL issued its final rule on April 6, 2016 with minimal substantive changes from its 2015 proposed version.[31]

U.S. Secretary of Labor, Thomas E. Perez, emphasized the importance of retirement security for the middle class and the rule's goal of closing loopholes that permit advisers to provide bad advice that results in devastating

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22. *See id.*

23. Arthur D. Postal, *Obama Pushes Fiduciary Standard Rule Redraft*, INSURANCENEWS.NET (Feb. 22, 2015), http://insurancenewsnet.com/oarticle/2015/02/22/Obama-Pushes-Fiduciary-Standard-Rule-Redraft-a-598081.html ("Middle class economics means that Americans should be able to retire with dignity after a lifetime of hard work . . . But today the rules of the road do not ensure that financial advisers act in the best interest of their clients when they give retirement investment advice, and it's hurting millions of working and middle class families.").

24. Mark Schoeff Jr., *Obama directs Labor Department to move ahead on fiduciary duty*, INVESTMENTNEWS (Feb. 23, 2015, 8:45 AM), http://www.investmentnews.com/article/2015 0223/FREE/150229979/obama-directs-labor-department-to-move-ahead-on-fiduciary-rule.

25. Definition of the Term "Fiduciary," 75 Fed. Reg. 65,263 (proposed Oct. 22, 2010) (to be codified at 29 C.F.R. pt. 2510).

26. Schoeff Jr., *supra* note 24.

27. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928, 21,936 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

28. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1375 (2010).

29. Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. at 21,937.

30. Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,958 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

31. *DOL's Finalized Fiduciary Rule Released*, 401KHELPCENTER.COM, http://www.401khelpcenter.com/401k/meigs_final_dol_fiduciay_rule_040516.html (last visited Sept. 6, 2016).

consequences for their middle-income clients.[32] These loopholes, especially those involving conflicts of interests that the advisers are not required to disclose, result from the changes in the retirement investment landscape that had been around since 1974, when ERISA was first enacted.[33]

Although ERISA's standards of conduct are strict and the penalties for violating them are substantial,[34] the rule applies these standards only to those who qualify as fiduciaries under the statute.[35] If the advice a person renders falls within the statutory definition of investment advice, that person is automatically a fiduciary under ERISA.[36] The proposed rule intended to broaden this definition because its narrow scope had created a loophole for BDs, permitting them to escape from the liabilities of being a fiduciary under ERISA.[37] The unfortunate consequences of this loophole were fraud and investment losses.[38] The DOL's goal was to provide better consumer investment protection by creating statutory flexibility that had long been overdue.[39] While the DOL's final rule achieves the goal of granting important protections for retirement plan investors against potentially bad advice, it will impose a much more heightened standard of duty for BDs, which may impact accessibility to advice for middle and low-income investors.

Section I of this Note lays out the fiduciary rules and standards under ERISA, the SEC's Investment Advisers Act of 1940 ("Advisers Act"), and the Financial Industry Regulatory Authority (FINRA), that applied to retirement plan BDs before the final rule. Section II lays out the relevant details of the DOL's Rule

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32. *Restricting Access*, *supra* note 17; *see also* EXEC. OFFICE OF THE PRESIDENT, THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS 3 (2015), https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf ("A retiree who receives conflicted advice when rolling over a 401(k) balance to an IRA at retirement will lose an estimated 12 percent of the value of his or her savings if drawn down over 30 years. If a retiree receiving conflicting advice takes withdrawals at the rate possible absent conflicted advice, his savings would run out more than 5 years earlier.").

33. *Restricting Access*, *supra* note 17; *History of EBSA and ERISA*, U.S. DEP'T OF LABOR, http://www.dol.gov/ebsa/aboutebsa/history.html (last visited Aug. 31, 2016).

34. *See ERISA Enforcement*, U.S. DEP'T OF LABOR, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement/erisa (last visited Sept. 6, 2016).

35. *See* 29 U.S.C. § 1132(g), (i) (2012). The types of equitable relief that the court may impose on the fiduciary in breach of its duty include unpaid contributions, interest on the contributions, reasonable attorney's fees, and up to double damages for each prohibited transaction if left uncorrected within ninety days. *Id.*

36. *See infra* notes 52–57 and accompanying text.

37. *Fact Sheet: Department of Labor Proposes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year*, U.S. DEP'T OF LABOR 4 (2015), https://www.dol.gov/sites/default/files/documents/featured/protectyoursavings/factsheetcoi.pdf [hereinafter *DOL Fact Sheet*].

38. *Id.*; *see also* As You Sow v. AIG Fin. Advisors, Inc., 584 F. Supp. 2d 1034, 1049–50 (M.D. Tenn. 2008) (holding that a broker committed fraud when he explicitly agreed to provide professional services to his clients while his real and secret intent was to misappropriate funds because it was a material omission).

39. *See DOL Fact Sheet* note 37, at 2.

and Best Interest Contract Exemption. Section III analyzes how the rule has changed the fiduciary standards for BDs. This Note concludes by exploring the potential impact the final rule may have for middle-income investors and highlights criticisms that the DOL received by industry professionals during the open comment period.

I. THE PREVIOUS STANDARDS OF FIDUCIARY DUTIES FOR REGISTERED INVESTMENT ADVISERS AND BROKER-DEALERS UNDER THE DEPARTMENT OF LABOR AND SECURITIES LAWS

A. An Introduction to the Employee Retirement Income Security Act of 1974

Congress enacted ERISA as a response to mismanagement and abuse of private pension funds.[40] Before ERISA's enactment, private pension funds were regulated primarily by the Internal Revenue Service (IRS),[41] which proved to be inadequate because the IRS's regulations "exist principally to produce tax revenue and to prevent evasion of tax obligations."[42] Prior to ERISA's enactment, only about five percent of workers who left the workforce with a pension plan received any benefits at all, and workers often lost their pension plans if they changed jobs.[43] Congress sought to impose safeguards for workers against these phantom retirement security benefits, and one of the solutions was to tighten fiduciary responsibilities and standards.[44]

1. Fiduciary Status Under ERISA Before the Final Rule

The simplest way to identify a fiduciary[45] under ERISA is to review the plan documents to identify the named fiduciary, i.e., the person whose name appears in the written documents.[46] However, any named fiduciary under the statute is only a fiduciary to the extent that he performs the duties described under the document.[47] Because of this, the statute's concept of a fiduciary includes a second category called "functional fiduciaries," which are those who become fiduciaries because of the nature of their discretionary authority "with respect to

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40. *History of EBSA and ERISA*, U.S. DEP'T OF LABOR, http://www.dol.gov/ebsa/aboutebsa/history.html (last visited Sept. 7, 2016).

41. *Id.*

42. SUBCOMM. ON LABOR, S. COMM. ON LABOR & PUB. WELFARE, 94TH CONG., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 207 (Comm. Print 1976), https://ia801702.us.archive.org/18/items/legihisto00unit/legihisto00unit.pdf.

43. *Id.* at 208–09.

44. *Id.* at 229.

45. *Definition of the Term "Fiduciary"*, U.S. DEP'T OF LABOR (Mar. 30, 2011), http://www.dol.gov/ebsa/newsroom/fsfiduciary.html ("ERISA defines a plan fiduciary to include anyone who gives investment advice for a fee or other compensation with respect to any moneys or other property of a plan, or has any authority or responsibility to do so.").

46. 29 U.S.C. § 1102(a)(2) (2012).

47. 29 U.S.C. § 1002(21)(A) (2012).

the management, assets, or administration of the plan."[48] Under the current statute, a person is a fiduciary when:

> (i) [H]e exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.[49]

Investment advisers are also fiduciaries under ERISA if they are registered under the Advisers Act.[50]

The DOL issued a five-prong test to determine whether a person is giving investment advice under ERISA in order to ensure that he may be properly held to ERISA's fiduciary standards. The person must:

> (1) [M]ake recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan. An investment adviser is not treated as a fiduciary unless each of the five elements of this test is satisfied for each instance of advice.[51]

It is this definition that the DOL changed in its final rule.

2. Fiduciary Standard under ERISA Before the Final Rule

The significance of determining who is a fiduciary under ERISA is the stringent standard by which the fiduciary must abide.[52] Although the statute provides a list of enumerated fiduciary duties,[53] courts have found that this list is non-exhaustive.[54]

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48. Custer v. Sweeney, 89 F.3d 1156, 1161 (4th Cir. 1996).

49. 29 U.S.C. § 1002(21)(A).

50. *Id.* § 1002(38)(B); *see also infra* note 59.

51. *Definition of the Term "Fiduciary"*, U.S. DEP'T OF LABOR (Mar. 30, 2011), http://www.dol.gov/ebsa/newsroom/fsfiduciary.html.

52. *Frequently Asked Questions: Fiduciary Responsibilities under an Apprenticeship and Training Plan*, U.S. DEP'T OF LABOR, http://www.dol.gov/ebsa/faqs/faq-atp.html (last visited Aug. 28, 2016).

53. *See* 29 U.S.C. § 1104 (2012).

54. *See* Pocchia v. NYNEX Corp., 81 F.3d 275, 278 (2d Cir. 1996) ("Because the statute does not enumerate or elaborate in any detail on the duties owed by a fiduciary to a plan beneficiary, the courts have been called upon to define the scope of a fiduciary's responsibilities."); *see also* Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1299 (3d Cir. 1993) ("Although the statute articulates a number of fiduciary duties, it is not exhaustive."); *see also* Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570 (1985) ("Rather than explicitly enumerating *all* the powers and duties of trustees and other fiduciaries, Congress invoked the

Primarily, fiduciaries must act "solely in the interest of participants and beneficiaries" with regard to their duties.[55] They must abide by four main duties: the duty to act prudently, the duty to diversify investments, the duty to follow the terms of the plan documents, and the duty of loyalty to the beneficiary.[56] Violating these duties may result in personal liability to restore losses the plan beneficiary incurred because of the breach.[57]

B. SEC Investment Advisers Act of 1940

Under federal securities laws, investment advisers are those who, for compensation, provide advice in the "purchasing, or selling [of] securities" or "promulgate[] analyses or reports concerning securities" as part of their regular course of business.[58] Investment advisers are required to register with the SEC.[59] However, brokers and dealers[60] are exempt from this definition if any investment advice they provide is "solely incidental to the conduct of [their] business as . . . broker[s] or dealer[s] who receive[] no special compensation [for the advice]."[61]

A broker is someone who is "engaged in the business of effecting transactions in securities for the account of others."[62] In other words, a broker acts as a middleman between a seller and a buyer and does not purchase the securities for its own account.[63] A dealer is someone who is "engaged in the business of buying and selling securities . . . for [its] own account through a broker or otherwise."[64] Both brokers and dealers must also register with the SEC.[65] BDs are those that act as both agents (brokers) and principals (dealers).[66]

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common law of trusts to define the scope of their authority and responsibility.") (emphasis in original).

55. *Health Plans & Benefits: Fiduciary Responsibilities*, U.S. DEP'T OF LABOR, http://www.dol.gov/dol/topic/health-plans/fiduciaryresp.htm (last visited Aug. 31, 2016) (discussing the responsibilities a fiduciary has when running an investor's plan).

56. *See* 29 USC § 1104(a)(1); *Health Plans & Benefits: Fiduciary Responsibilities*, *supra* note 55 ("Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. In addition they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. They also must avoid conflicts of interest.")

57. *Health Plans & Benefits: Fiduciary Responsibilities*, *supra* note 55.

58. 15 U.S.C. § 80b-2(a)(11) (2012) (alteration in original).

59. *Id.* § 80b-3(a).

60. *Broker-Dealer*, INVESTOPEDIA, http://www.investopedia.com/terms/b/broker-dealer.asp (last visited Aug. 31, 2016) ("A brokerage acts as a broker (or agent) when it executes orders on behalf of clients, whereas it acts as a dealer, or principal, when it trades for its own account.").

61. 15 U.S.C. § 80b-2(a)(11) (alteration in original).

62. *Id.* § 80b-2(a)(3); Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4) (2012).

63. *Broker-dealer*, INVESTOPEDIA, http://www.investopedia.com/terms/b/broker-dealer.asp (last visited Aug. 31, 2016).

64. 15 U.S.C. § 78c(a)(5); § 80b-2(a)(7) (alteration in original).

65. *Id.* § 78o(a)(1).

66. *Broker-dealer*, INVESTOPEDIA, http://www.investopedia.com/terms/b/broker-dealer.asp (last visited Aug. 31, 2016).

RIAs are not only subject to the SEC's fiduciary standards under the Advisers Act,[67] but are often also subject to ERISA's standards, especially when dealing with pension funds.[68] Under the Advisers Act, an RIA owes the duties of loyalty and care to his clients, which include the obligation to serve his clients' best interests before his own, and to be reasonably well informed so that his recommendations are not based on materially inaccurate or incomplete information.[69] An RIA must also fully disclose to his client any conflicts of interest that could influence the objectivity of the advice rendered to the client.[70]

BDs, on the other hand, must generally comply with the standards of conduct promulgated by the SEC's Securities Exchange Act of 1934 and by self-regulatory organizations (SRO),[71] such as FINRA, because they rarely meet the fiduciary requirements under ERISA.[72] In other words, BDs do not have any fiduciary obligations to their clients unless they are also RIAs or their relationship with their clients involves a degree of trust and confidence over investment advice,[73] which is rarely the case.[74] As a result, when BDs are only under the SEC's oversight regime, they are free to suggest investments to their clients that may benefit them more than their own clients as long as the BDs comply with SEC and FINRA standards.

FINRA is an independent organization recognized by the SEC as an enforcer of its own rules to protect securities investors and to ensure that "the securities

67. Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,425 (Apr. 19, 2005).

68. *See* 29 U.S.C. § 1002(38) (defining the term "'investment manager" as someone who is registered under the Investment Advisors Act of 1940); *see also supra* note 40 and accompanying text.

69. *See* SECS. & EXCH. COMM'N, *supra* note 7, at 22.

70. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200 (1963) (noting that the goal of the Advisers Act is to protect against "conduct that tempts dishonor," and holding that failing to disclose material facts "must be deemed fraud or deceit").

71. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. at 20,433.

72. Letter from Marcia E. Asquith, Senior Vice President and Corp. Sec'y, Fin. Indus. Regulatory Auth., to the U.S. Dep't of Labor 1 (July 17, 2015), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf [hereinafter *FINRA Letter*] (explaining FINRA's role as the independent regulatory authority of the broker-dealer industry); *see* Ryan C. Fuhrmann, *Choosing a Financial Advisor: Suitability vs. Fiduciary Standards*, INVESTOPEDIA, http://www.investopedia.com/articles/professionaleducation/11/suitability-fiduciary-standards.asp?layout=infini&v=1A (last visited Sept. 1, 2016).

73. Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,849 (Mar. 7, 2013).

74. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. at 20,433 n. 98 (citing cases in which the courts have held that broker-dealers are not generally subject to fiduciary duties unless the client has placed trust and confidence in the broker-dealer in the investment advice context); *see also* Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. at 14,849 n. 3.

industry operates fairly and honestly."[75] FINRA regulates BD conduct under its Rule 2111 suitability standard.[76] A broker must have reasonable grounds for believing that its recommendations are suitable for the customer based on the customer's investment profile.[77] The broker must also refrain from using any "manipulative, deceptive or other fraudulent device or contrivance" when making its sales.[78]

C. Department of Labor's Rule and Exemption

The final rule attempts to protect the expectations of clients who receive some form of investment advice and rely upon this advice.[79] The DOL expressed that passing a new regulation to protect these interests is very important because, in spite of dramatic changes in the types of retirement plans Americans choose today in comparison to when ERISA was first enacted, the rules that govern retirement investment advice have remained the same since 1975.[80]

1. The New Definition of "Fiduciary"

The change to the definition of fiduciary replaces the prior five-part test.[81] In particular, the rule redefines the types of investment advice that are subject to ERISA regulations as recommendations. Under the final rule, a person(s) renders investment advice if, for a fee or other compensation, the advice is a recommendation as to (1) buying, holding, or trading securities in a pension plan; (2) investing in securities after the investment is "rolled over, transferred, or distributed from a plan"; or (3) managing the investment regarding policies and strategies and portfolio management, among other things.[82] In addition, the final rule describes certain criteria that must exist before the professional is bound by a fiduciary duty to the client: (1) the person must "represent or acknowledge that they are acting as a fiduciary" under ERISA; (2) there must be

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75. *About FINRA*, FIN. INDUS. REGULATORY AUTH., https://www.finra.org/about (last visited Aug. 28, 2016).

76. *FINRA Rule 2111 (Suitability) FAQ*, FIN. INDUS. REGULATORY AUTH., http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq (last visited Aug. 30, 2016).

77. *2111. Suitability*, FIN. INDUS. REGULATORY AUTH., http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 (last visited Oct. 30, 2016).

78. *2020. Use of Manipulative, Deceptive or Other Fraudulent Devices*, FIN. INDUS. REGULATORY AUTH., http://finra.complinet.com/en/display/display_content.html?rbid=2403&element_id=5513 (last visited Oct. 30, 2016).

79. Press Release, U.S. Dep't of Labor, U.S. Labor Department Seeks Public Comment on Proposal to Protect Consumers from Conflicts of Interest in Retirement Advice (Apr. 14, 2015), http://www.dol.gov/opa/media/press/ebsa/EBSA20150655.htm ("[I]f someone is paid to give you retirement investment advice, that person should be working in your best interest . . . .").

80. *DOL Fact Sheet*, *supra* note 37, at 2.

81. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,948 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

82. *Id.* (describing what constitutes investment advice under the final rule).

some type of "agreement, arrangement, or understanding that the advice is based on . . . the needs of the advice recipient;" or (3) the advice is individualized to the needs of the recipient of the advice.[83] Finally, the rule defines a "recommendation" as a communication that, from an objective standard, "would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action" based on its content or context.[84]

2. The "Best Interest Contract" Exemption

Because the new definition of fiduciary is broader, the DOL has also finalized its Best Interest Contract Exemption (BICE).[85] The goal of the exemption is to allow entities that currently provide investment advice to retirement investors in the retail market,[86] but do not fall under the fiduciary status of ERISA or consider themselves ERISA fiduciaries, to continue providing advice without being in violation of ERISA provisions.[87] In order to qualify for the exemption, the adviser must abide by a number of requirements, including the duty to conduct business in an impartial manner and to the best interest of the retail investor.[88]

The proposed BICE focused on what kind of compensation these advisers receive that may create a conflict of interest if they become ERISA fiduciaries.[89] Some of the types of compensation that the proposed BICE intended to exempt included commissions paid by third parties (e.g., the plan provider, other investment providers, or financial institutions), revenue sharing, and other forms of compensation by third parties resulting from the sale of the plan.[90] The final BICE eliminated this compensation-based limitation and implemented a more

83. *Id.* (listing the types of fiduciary relationships that are covered under the final rule).

84. *Id.* ("[A] series of actions, directly or indirectly (e.g., through or together with any affiliate), that may not constitute recommendations when viewed individually may amount to a recommendation when considered in the aggregate. It also makes no difference whether the communication was initiated by a person or a computer software program.").

85. Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,003 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2550).

86. *See What is the Difference Between Retail Investors and Institutional Investors?*, INVESTORGUIDE.COM, http://www.investorguide.com/article/11202/what-is-the-difference-between-retail-investors-and-institutional-investors/ (last visited Sept. 7, 2016). "Retail investor" is also known as an "individual investor," where the quantity of shares bought is usually small. An "institutional investor," on the other hand, is a large investor such as banks, mutual funds, and pension funds. *Id.*

87. Best Interest Contract Exemption, 81 Fed. Reg. at 21,002.

88. *See DOL Fact Sheet*, *supra* note 37, at 3–4 ("The 'best interest contract exemption' will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client's best interest first and disclose any conflicts that may prevent them from doing so.").

89. Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960, 21,966 (Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550).

90. *Id.* at 21,961.

flexible standard in which the fee structures the DOL attempted to regulate in the proposed BICE are allowed so long as the advisers "implement appropriate safeguards against the harmful impact of conflicts of interest on investment advice."[91]

To qualify for BICE status, the advisers and their firms must contractually agree to adhere to Impartial Conduct Standards,[92] acknowledge to their clients that they are investment advice fiduciaries, ensure that they have adopted policies that would mitigate potential material conflicts of interest, not incentivize the advisers to provide advice that is contrary to their clients' best interest, and disclose whether potential material conflicts of interest exist.[93] A conflict of interest is material if the adviser "has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor."[94] If the adviser does indeed give any potentially materially misleading advice, the DOL further clarified that the adviser is liable only if the advice was materially misleading at the time it was made.[95]

The Best Interest standard is fundamental to the Impartial Conduct Standards.[96] Under these final standards, the adviser must agree to act in the retail investor's best interest by giving advice that "reflects the care, skill, prudence, and diligence under the circumstances . . . that a prudent person" would exercise based on the investor's goals and financial situation, "without regard to financial or other interests of the [a]dviser."[97] The compensation that the adviser receives must be no more than reasonable in relation to the services rendered, and whatever the adviser discloses in order to qualify for the exemption must not be misleading.[98]

The DOL calls this a "principles-based approach" because it is a broad rule that adapts to a variety of business practices, as opposed to a set of objective requirements.[99] This way, the BICE aligns with the DOL's goal of protecting the interest of both the client and the adviser while still giving the adviser flexibility to determine how to satisfy the interests and comply with his fiduciary

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91. Best Interest Contract Exemption, 81 Fed. Reg. at 21,003.

92. *Id.* at 21,008. The Impartial Conduct Standards require that the adviser act in his client's best interest. These standards mirror current ERISA and trust law fiduciary standards, as they also require that the adviser act "without regard to the financial or other interests of the Adviser, Financial Institution, or their Affiliates, Related Entities or any other party." *Id.* at 21,026.

93. *Id.* at 21,007.

94. *Id.* at 21,033.

95. *Id.* at 21,031.

96. *Id.* at 21,027.

97. *Id.* (alteration in original) (defining the "best interest" standard).

98. *Id.* at 21,029, 21,031.

99. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928, 21,929 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

duties.[100] This "allow[s] [advisers and] firms to continue to set their own compensation practices so long as they . . . commit to putting their client's best interests first" and disclose any conflicts of interest that could interfere with that commitment.[101]

II. IMPACT OF DEVELOPMENT

The DOL estimated that a new fiduciary rule could save retail investors between "$95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years."[102] This prediction was based only on the elimination of "front-end-load sharing,"[103] a scheme in which intermediaries, such as brokers and dealers, receive a commission from the retail investor for their expertise as part of an investment purchase.[104] For example, if a client intends to invest $10,000 in a mutual fund with a three percent front-end load, the broker would receive $300 as commission for the purchase from the $10,000, but the actual investment amount for the client's mutual fund would equal $9,700 instead of the original $10,000. In a twenty-year period, an initial investment of $9,700 in a standard mutual fund without any additional contributions to the fund is estimated to yield approximately $31,109,[105] whereas an initial investment of $10,000 would yield for the client approximately $32,071, all things being equal.[106]

Being informed as an investor is extremely important,[107] but financial literacy in the United States is weak.[108] The additional complexities that accompany the current investment market for those seeking investment retirement options

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100. *Id.* at 21,929; *DOL Fact Sheet*, *supra* note 37, at 1. In response to comments, the DOL also clarified that this final standard is a codification of "basic, well-established obligations of fair dealing and fiduciary conduct[,]" rather than being a new standard. Best Interest Contract Exemption, 81 Fed. Reg. at 21,032 (alteration in original).

101. *DOL Fact Sheet*, *supra* note 37, at 3 (alteration in original).

102. U.S. DEP'T OF LABOR, REGULATING ADVICE MARKETS: REGULATORY IMPACT ANALYSIS FOR FINAL RULE AND EXEMPTIONS 9 (2016), https://www.dol.gov/ebsa/pdf/conflict-of-interest-ria.pdf.

103. *Id.* at 10.

104. *Front-End Load*, INVESTOPEDIA, http://www.investopedia.com/terms/f/front-end load.asp (last visited Sept. 10, 2016).

105. *See Time Value of Money Calculator*, THE MUTUAL FUND STORE, https://www.mutual fundstore.com/time-value-of-money-calculator (last visited Sept. 10, 2016) (calculating the rate of return for mutual funds with a three percent front-end loan).

106. *See id*. (calculating the rate of return for mutual funds without a three percent front-end loan).

107. *See generally* U.S. DEP'T OF LABOR, A LOOK AT 401(K) PLAN FEES 1 (2013), http://www.dol.gov/ebsa/publications/401k_employee.html (emphasizing the importance for investors to make informed investment decisions).

108. David H. Bailey & Jonathan M. Borwein, *How Financially Literate Is the Investing Public?*, HUFFINGTON POST (Sept. 28, 2014), http://www.huffingtonpost.com/david-h-bailey/how-financially-literate-investing-public_b_5625649.html.

increase investor reliance upon investment advisers for bona fide advice.[109] This creates a system in which a non-fiduciary adviser, whether maliciously or not, can mislead clients for personal gain.[110] As with the example of front-end-load sharing, if an investor was given the choice between the two returns for the same out-of-pocket expense, it should be obvious that the investor would prefer the option with the higher yield and no hidden fees.

Before the final rule, a BD suffered no legal repercussions under ERISA for recommending such a plan to its investor client because it had no such duty to the client.[111] The BD would simply need to ensure that the plan is suitable for its client's needs, the current standard under the SEC and FINRA's regime, and serve as the intermediary for the transaction between the plan's provider and the client.[112] The final rule widens ERISA's reach far enough to bring BDs engaging in such transactions relating to pension plans under its jurisdiction, imposing much stricter standards of conduct, unless the BD qualifies under the BICE.[113] Once a fiduciary under ERISA, the BD will have to not only disclose the front-end-load sharing properly, but the BD will also be subject to ERISA's fiduciary duties.[114] This means that BDs have the additional burden of acting in their clients' best interest.

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109. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928, 21,932 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

110. *See* Bailey & Borwein, *supra* note 108 (stating that investors can be led astray by investments that look good on paper, but are unsuccessful in practice).

111. Limitations and sanctions exist when BDs engage in such practices, but they are only deemed dishonest or unethical when the BD misstates or misleads the investors, not through omissions. *See NASAA Statement of Policy: Dishonest or Unethical Business Practices by Broker-Dealers and Agents in Connection with Investment Company Shares*, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION (Apr. 27, 1997), http://www.nasaa.org/wp-content/uploads/2011/08/20-Dishonest_Practices.pdf (the dishonest practice may be subject to disciplinary action by an alternative statute).

112. *See FINRA Rule 2111 (Suitability) FAQ*, FIN. INDUS. REGULATORY AUTH., https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq (last visited Aug. 30, 2016) (stating that Rule 2111 requires broker-dealers to believe that a recommended strategy is suitable for the customer); *see also* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,425 (Apr. 19, 2005) (arguing that there have been concerns about broker-dealers and the lack of a more narrow rule defining suitability for their clients).

113. *See* Definition of the Term "Fiduciary," 75 Fed. Reg. 65,263, 65,266 (proposed Oct. 22, 2010) (to be codified at 29 C.F.R. pt. 2510).

114. *See, e.g.*, *ABC Plan: 401(k) Plan Fee Disclosure Form*, U.S. DEP'T OF LABOR, http://www.dol.gov/ebsa/pdf/401kfefm.pdf (last visited Nov. 4, 2016) (displaying the information that needs to be disclosed once a BD is subject to ERISA duties).

III. Possible Changes to Fiduciary Duties Now that the DOL Adopted the Final Rule

A. Many Registered Broker-Dealers Will Likely Become Fiduciaries under the DOL's Final Rule Thereby Subjecting Them to ERISA's Standards of Conduct

As explained above, under the final rule, a fiduciary is one who provides investment recommendations, for a fee or other compensation, related to: (1) buying, holding, or trading securities in a pension plan; (2) investing when the investment is "rolled over, transferred, or distributed from a plan;" or (3) managing the investment, such as policies and strategies and portfolio management.[115] This new definition complies with the DOL's goal: to provide more adequate consumer protection measures.[116] By encompassing not only registered advisers, but also anyone who is relied upon by investors for advice, the DOL intends to discourage advisers from committing fraud or taking advantage of their clients for their own financial gains by designating them as fiduciaries under the strict requirements of ERISA.[117]

As a result, many BDs will likely fall within the final rule's definition of fiduciary because they very often, for compensation, provide investment advice to their clients in the course of their regular business practices.[118] Clients generally seek the advice of their BDs when managing their investment portfolios,[119] and the advice is also commonly personalized to fit the clients' needs and their financial status.[120]

Not all BDs will be fiduciaries, however. The DOL has clarified that those who act strictly as brokers or dealers, that is they act under the direction of their clients without providing any type of investment advice,[121] will not be

115. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,948 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550).

116. *DOL Fact Sheet*, *supra* note 37, at 1.

117. *DOL Fact Sheet*, *supra* note 37, at 1–2 ("Being a fiduciary simply means that the adviser must provide impartial advice in their client's best interest and cannot accept any payments creating conflicts of interest unless they qualify for an exemption intended to assure that the customer is adequately protected.").

118. *See* Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,849 n. 3 (Mar. 7, 2013).

119. Secs. & Exch. Comm'n, *supra* note 7, at i ("[I]nvestors rely on broker-dealers and investment advisers for investment advice and expect that advice to be given in the investors' best interest.").

120. *See id.* at 10–11 ("Generally, the compensation of a broker-dealer relationship is transaction-based and is earned through commissions, mark-ups, mark-downs, sales loads or similar fees on specific transactions, where advice is provided that is solely incidental to the transaction. A brokerage relationship may involve incidental advice with transaction-based compensation, or no advice and, therefore no charge, for advice.").

121. *See* Fin. Planning Ass'n v. SEC, 482 F.3d 481, 493–94 (D.C. Cir. 2007) (holding that the SEC, under the Advisers Act, exempted from the definition of "investment adviser" any broker-dealer who provides advice that is "solely incidental" to its brokerage services).

fiduciaries, just as they were not fiduciaries under the previously existing rules.[122] In addition, the DOL also included certain types of communication that are exempt from qualifying as a "recommendation" under the final rule, which indicates that the more personalized the communication, the more likely it will be considered a "recommendation" under the final rule.[123]

Before the final rule, BDs were held to a much lower fiduciary standard than RIAs under the SEC's regime.[124] While RIAs were required to disclose all conflicts of interest to comply with their duties of loyalty and care, BDs had flexibility to not disclose any self-dealing when rendering their investment advice as long as the advice satisfied the requirements under the suitability standard.[125] This meant that while RIAs were required to provide objective investment advice so that their clients could make intelligent investment decisions, BDs were allowed to direct their clients to invest for the BDs' own personal gains, even when investment opportunities more beneficial to the client were available at the time.[126] In 2013 the SEC recognized this problem and issued a request for information regarding the potential economic effect of issuing a new standard of conduct for BDs that would be more comparable to the standard for RIAs.[127]

BDs have been able to evade ERISA liability by showing that their services rendered did not fall under the definition of investment advice.[128] The DOL noticed that its five-prong test for investment advice, in defining the scope of its

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122. *DOL Fact Sheet*, *supra* note 37, at 3 ("As under the current rules, when a customer calls a broker and tells the broker exactly what to buy or sell without asking for advice, that transaction does not constitute investment advice.").

123. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,997–98 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550) (enumerating the carve-outs, which include general marketing communication, investment education, and providing financial data when the client requests it).

124. *See* Fuhrmann, *supra* note 72 (explaining that before the final rule, BDs only had to meet a suitability standard); *see also FINRA Letter*, *supra* note 72 (arguing that BDs should be held to the "best interest" standard, a higher fiduciary standard than before).

125. Kaleda, *supra* note 10, at 13.

126. *See id.* at 12.

127. Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,848 (Mar. 7, 2013) (recognizing that broker-dealers and RIAs nowadays provide essentially the same services for retail investors).

128. *See, e.g.*, Black v. Bresee's Oneonta Dep't Store, Inc. Sec. Plan, 919 F. Supp. 597, 606 (N.D.N.Y. 1996) (holding that there was no fiduciary relationship between a salesperson and a third-party when the investment advice was only provided to the principal on an ongoing basis, even though the third-party relied on the same information but obtained it through the principal). *But cf.* Thomas, Head & Greisen Emps. Trust v. Buster, 24 F.3d 1114, 1117–19 (9th Cir. 1994) (holding that the defendant had fiduciary status because he regularly met with client to discuss investment strategies for compensation); Olson v. E.F. Hutton & Co., 957 F.2d 622, 626–27 (8th Cir. 1992) (holding that a fiduciary relationship existed when both the clients and the adviser had an understanding that the investment advice would be the primary basis for the client's investment decisions).

meaning, effectually created "an 'escape hatch' from fiduciary status."[129] Because the test required that the adviser must show that it provided the advice on a regular basis, those who provided the advice only once had no duty to act in the client's best interest.[130] And because of the mutuality requirement, the "escape hatch" was also available for those who claimed that they did not understand that their client would rely on the advice as a primary basis for investment decisions, even if the client did, in fact, primarily rely on it.[131]

Because of the DOL's final rule, BDs must now comply with ERISA's more stringent fiduciary duties unless they qualify for the BICE.[132]

B. Increased Administrative Requirements and Liabilities for Broker-Dealers Under the Final Rule

BDs were able to escape the reach of ERISA because they had not been held to the same standards of conduct and liabilities as RIAs and other ERISA fiduciaries.[133] Even though FINRA's suitability standard required that a broker's recommendations be suitable based on the customer's financial situation, it did not mean that the BD was required to recommend the least expensive plan available to the client.[134] A BD that provided some form of advice to the client in connection with securities was able to shirk ERISA fiduciary duties by claiming that investment advice was ancillary to its other services (i.e., advice is not a primary basis for investment decisions),[135] the compensation was not for the advice itself but for the brokerage services,[136] and that the advice was not rendered on a regular basis.[137]

Additionally, even though FINRA brought a number of disciplinary actions against BDs that, for example, recommended particular securities motivated by higher commissions,[138] a BD was still in compliance with FINRA regulations as long as it made a recommendation that was consistent with the client's financial

129. U.S. DEP'T OF LABOR, FIDUCIARY INVESTMENT ADVICE: REGULATORY IMPACT ANALYSIS 2, 138 (2015), https://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

130. *Id.*

131. *Id.*

132. *DOL Fact Sheet*, *supra* note 37, at 1, 3.

133. U.S. DEP'T OF LABOR, *supra* note 129, at 149.

134. *In re* John M. Reynolds, 50 S.E.C. 805, SEC LEXIS 2725, at *3 (1992); *FINRA Rule 2111 (Suitability) FAQ*, FIN. INDUS. REGULATORY AUTH., https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq (last visited Aug. 30, 2016).

135. Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,438 (Apr. 19, 2005).

136. *Id.* at 20,425.

137. *Id.*

138. *FINRA Rule 2111 (Suitability) FAQ*, FIN. INDUS. REGULATORY AUTH., https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq (last visited Aug. 30, 2016) (listing examples of cases in which the "best interests" standard was violated).

situation and needs.[139] This interpretation of the suitability standard appeared to be sufficiently broad to allow all but blatant violations of the standard.[140]

With the final rule, a BD who has thus far been accustomed to the leeway that the SEC and FINRA's standards of conduct afford will suddenly find more restrictions on what it can and cannot do if it renders any investment advice to its clients. The only way a BD may escape from all the liabilities that accompany a fiduciary duty under ERISA is to qualify for the BICE.[141] Qualifying for the BICE, however, still comes with additional administrative costs for BDs who want to avoid becoming fiduciaries under ERISA. Not only must they contractually agree that they will put the client's best interest first and disclose potential material conflicts of interest, they must also adopt compatible policies and retain all documents and data related to their advice,[142] which will likely increase administrative burdens for BDs and their firms.[143]

C. The Final Rule May Shut Out Middle Income Investors Because of the Increased Costs

With increased paperwork and administrative procedures come increased costs. Not only is there an increase in workload, which increases labor costs by increasing the number of hours necessary for establishing and enforcing the new procedures and policies, there is also more potential for human error.[144] An increase in the possibility of human error also means an increased possibility for potential liabilities, such as missing important procedures in the course of business or simple carelessness, which could result in an unintentional or

139. *See, e.g.*, Wendell D. Belden, Exchange Act Release No. 47,859, 80 SEC Docket 563 (May 14, 2003).

140. Greg Oguss, *Should Size or Wealth Equal Sophistication in Federal Securities Laws?*, 107 NW. U. L. REV. 285, 316 (2012) ("[T]he brokerage firm and its employees must merely adhere to an ordinary negligence standard of care in dealing with customers. For wronged investors, this makes recovery in suitability cases – already difficult for sophisticated customers – all but impossible."); *see* RIC EDELMAN, THE TRUTH ABOUT MONEY 188–89 (3d ed. 2004) (listing five common BD techniques that are illegal).

141. Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,003 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2550).

142. *Id.* at 21,052 (laying out the standards and procedures BDs must meet to obtain BICE status under the final rule).

143. Letter from the Committee on Capital Markets Regulation, to U.S. Dep't of Labor (Sep. 24, 2015), http://www.dol.gov/ebsa/pdf/1210-AB32-2-03023.pdf.

144. *See* INTERMEC, ELIMINATING PAPERWORK IS MORE THAN JUST EFFICIENT 2 (2008), http://www.intermec.com/public-files/white-papers/en/EAM-EliminatePaperwork_wp_web.pdf ("Everyday mistakes and inefficiencies are a drain on profits . . . . Mistakes are human, and when they happen, they cost money."); *see also* Norman Ireland, *The Hidden (and not so hidden) Costs of Paperwork*, LYCEUM (Mar. 11, 2013), http://www.onetouchpayroll.com/blog/2013/03/11/costs-of-paperwork/ ("[Paper work] is tedious and typically requires that we touch the documents more than once often due to errors. . . . There are some obvious costs associated with paperwork, such as the increased time it takes to manage errors. Errors decrease productivity for both the worker submitting the paperwork and the person trying to gather the data to submit the information." (alteration in original)).

accidental fiduciary status.[145] But that is not the only effect ERISA fiduciary duties will have on BDs.

In addition to increased labor costs, BDs will have to add the cost of the risk of liability and the penalties that accompany ERISA liabilities and related lawsuits into their operational budgets.[146] Both RIAs and BDs perform a broad range of services.[147] Because those services currently tend to be so similar, it has become difficult to differentiate between someone acting as an investment adviser or just as a BD.[148] Even though BDs generally only offer investment advice that is incidental to the services they provide as either brokers or dealers—because they may have "multiple relationships and accounts . . . with varying levels of service provided to each account" with their retail customers[149]—BDs are at risk of accidentally and unintentionally becoming fiduciaries in these complicated client relationships.

The consequences of being in violation of ERISA duties are significant. In addition to being subject to state and local laws, fiduciaries under ERISA are subject to civil penalties, including equitable relief and attorney's fees and costs;[150] and to criminal penalties,[151] which have increased with the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").[152] Sarbanes-Oxley increased the

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145. Under the final rule, a one-time offering of investment advice is sufficient to turn an individual into a fiduciary. If an individual claims that he is a fiduciary, even if under the final rule he would actually not qualify as one, he is also automatically deemed a fiduciary. Bernice Napach, *What Advisors May Not Know About the DOL Fiduciary Rule*, THINKADVISOR (Aug. 26, 2016), http://www.thinkadvisor.com/2016/08/26/what-advisors-may-not-know-about-the-dol-fiduciary. Discussion of rollovers between retirement accounts is a fiduciary act as well because explaining the advantages and disadvantages of doing so to the client requires impartiality. Matt Sommer, *Five Action Steps for Advisors to Consider in New Fiduciary Regime*, JANUS (Apr., 2016), https://www.janus.com/resource/x171702?document=advisor%2FRetirement%2F40912_DOL%20Rule_FinancialPlanningMag_%200416.pdf.

146. *See* U.S. DEP'T OF LABOR, *supra* note 129, at 170–72 (noting the DOL's in-depth analysis on the potential costs and risks for existing and potential fiduciaries under the final rule).

147. *See* SECS. & EXCH. COMM'N, *supra* note 7, at 7 ("Many investment advisers also engage in other non-advisory businesses, such as insurance broker or agent, or as a registered broker-dealer or registered representative of a broker-dealer."); *see also* SECS. & EXCH. COMM'N, *supra* note 7, at 8–12 (describing the broad variety of services brokers and dealers provide to their clients, some of which include brokerage services and products to retail customers, research and advice on investments, providing educational information to clients, selling securities out of their own inventory, and acting as principals in retirement accounts).

148. Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,424 (Apr. 19, 2005).

149. SECS. & EXCH. COMM'N, *supra* note 7, at 11.

150. 29 U.S.C. § 1132(g), (i) (2012) (the types of equitable relief that the court may impose on the fiduciary in breach of its duty include unpaid contributions, interest on the contributions, reasonable attorney's fees, and up to double the amount of damages for each prohibited transaction if left uncorrected within ninety days).

151. *See* 29 U.S.C. § 1131 (2012) (reflecting the new criminal penalties, as amended by Sarbanes-Oxley Act of 2002).

152. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in 15, 18, 28 and 29 U.S.C.).

criminal penalties for a violation of ERISA from fines of up to $5,000 to $100,000 and increased imprisonment from up to one year to ten years for an individual.[153] For non-individual persons, such as firms, Sarbanes-Oxley increased the fine from $100,000 to $500,000.[154]

Unfortunately, because of these additional risks and compliance requirements, many industry professionals claim that service providers will inevitably shift that cost to their clients, by increasing the price of their services.[155] Oliver Wyman, a management consulting firm, published its own study on the impact the rule could have on retail investors, finding it likely that costs for investors could increase anywhere between 73% to 196% as a result of the restructuring that investment and brokerage firms will have to undergo to comply with the new requirements.[156] Some see robo-advisers[157] as a potential solution to this problem.[158] They suspect, however, that although they may be useful for beginning investors, they are not the best tools for people who seek advice for

153. Sarbanes-Oxley Act § 805.

154. *Id.*; *see* Pension and Welfare Benefits Administration; Strategic Enforcement Plan, 65 Fed. Reg. 18,208, 18,209 (Apr. 6, 2000) ("Enforcement action is warranted in such cases to ensure the integrity of the system even though the plan participants and beneficiaries incurred no actual harm. Situations involving self-dealing, conflicts of interest, and gross imprudence are examples of other types of violations that may warrant investigation even in the absence of demonstrated harm to plan participants.").

155. *See* Marlene Y. Satter, *ICI has harsh words for DOL-proposed fiduciary rule*, BENEFITSPRO (Aug. 12, 2015), http://www.benefitspro.com/2015/08/12/ici-has-harsh-words-for-dol-proposed-fiduciary-rul; Aaron Vehling, *High Compliance Costs Could Sink DOL Fiduciary Rule*, LAW360 (July 20, 2015, 9:24 PM), http://www.law360.com/articles/681069/high-compliance-costs-could-sink-dol-fiduciary-rule; *see also Democrats Against ObamaSave*, WALL ST. J. (Oct. 11, 2015, 6:19 PM), http://www.wsj.com/articles/democrats-against-obamasave-1444601940 (surveying studies that estimate higher compliance costs).

156. OLIVER WYMAN, THE ROLE OF FINANCIAL ADVISORS IN THE U.S. RETIREMENT MARKET 38 (2015), http://www.fsrountable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirement-market-Oliver-Wyman.pdf.

157. *Robo-advisor (robo-adviser)*, INVESTOPEDIA, http://www.investopedia.com/terms/r/roboadvisor-roboadviser.asp (last visited Aug. 30, 2016) ("A robo-advisor (robo-adviser) is an online wealth management service that provides automated, algorithm-based portfolio management advice without the use of human financial planners. Robo-advisors (or robo-advisers) use the same software as traditional advisors, but usually only offer portfolio management and do not get involved in more personal aspects of wealth management, such as taxes and retirement or estate planning.").

158. *See* Janet Levaux, *Who Wins, Who Loses With New DOL Rule? $3 Trillion in Play*, THINKADVISOR (Dec. 31, 2015), https://www.thinkadvisor.com/2015/12/31/who-wins-who-loses-with-new-dol-rule-3-trillion-in?t=mutual-funds (citing to Morningstar analyst Stephen Ellis who concluded that approximately $250 billion to $600 billion may shift from full-service adviser firms to passive investment management firms and robo-advisers); *see also* Joe Tomlinson, *The DOL's Fiduciary Rule: What We Can Learn from the U.K.*, ADVISOR PERSPECTIVES (Sept. 28, 2015), http://www.advisorperspectives.com/articles/2015/09/28/the-dol-s-fiduciary-rule-what-we-can-learn-from-the-u-k.pdf (suggesting that robo-advising, while not a complete solution for lower income investors who would be affected by the DOL's final rule, can be a valuable tool in combination with other tools, such as educating investors and subsidized financial advice, for retirement plan investors).

retirement investment plans with long-term goals, such as planning for a child's education or building retirement investment portfolios.[159]

Currently, RIAs' fees are based on a percentage of the value of the assets they manage for their clients at an hourly or a fixed fee rate; they very rarely receive commission-based compensation.[160] Conversely, BDs generally charge a transaction-based fee or receive commissions on the transactions.[161] Under the final rule, some BDs could feel compelled to change from their commission-based compensation structure to a fee-based structure to offset the additional costs they will likely incur because of the increase in liabilities.[162] This shift could increase costs for retail investors, lowering their return on investment, especially for those who do not invest actively.[163] This is significant because those who regularly rely on BDs are generally from the middle class and seek investment advice on an irregular basis.[164]

IV. CONCLUSION

When an investment adviser can easily avoid being a fiduciary by invoking technicalities in the statutory definition, he can successfully avoid liabilities and penalties under ERISA, which can be very burdensome. However, the consequences of the adviser's ability to avoid a fiduciary status have been significant. When an investor relies on an industry professional for advice for compensation, the expectation is that the advice arises out of the duty to act in the client's best interest. The final rule is the DOL's attempt to align this expectation with the adviser's standard of conduct to protect the investor. It has the potential to cause tremendous and expensive transformations in the BD industry. This may end up hurting the middle-income clients in which the exact regulations were meant to help.

159. *See* Larry Ludwig, *The Rise of the Robo-Advisors – Should You Use One?*, INVESTORJUNKIE (Aug. 14, 2016), https://investorjunkie.com/35919/robo-advisors/ (explaining that the one-size-fits-all formula of robo-advisers does not work for financial advice and that financial advisers are more capable of giving investment advice and recommendations about long-term life decisions); *see also* ROBERT LITAN & HAL SINGER, ECONOMISTS INCORPORATED, GOOD INTENTIONS GONE WRONG: THE YET-TO-BE-RECOGNIZED COSTS OF THE DEPARTMENT OF LABOR'S PROPOSED FIDUCIARY RULE 18 (2015), http://www.ei.com/wpcontent/uploads/2015/07/LitanSingerFiduciary.pdf (explaining that robo-advisers, while they may provide valuable investment service to lower income investors, they are not capable of replacing an RIA or BD's ability to encourage their clients to remain in the market, particularly during troubled market periods).

160. SECS. & EXCH. COMM'N, *supra* note 7, at 7.

161. SECS. & EXCH. COMM'N, *supra* note 7, at 10–11.

162. SECS. & EXCH. COMM'N, *supra* note 7, at 151–52; *see* Sommer, *supra* note 145 ("The final rule also states that recommending a commission-based client move to a fee-based account is a prohibited transaction if not in the client's best interests.").

163. SECS. & EXCH. COMM'N, *supra* note 7, at 152.

164. *Overview of the Independent Broker-Dealer Industry*, FINANCIAL SERVICES INSTITUTE, http://www.financialservices.org/uploadedFiles/FSI_Content/Docs/Advocacy/Backgrounder_Independent-Broker-Dealer.pdf (last visited Aug. 30, 2016).