Harmonization of the Best Interest Standard

Issue and Current Status

Fiduciary duty includes both a duty of care and a duty of loyalty. Collectively, these duties require a fiduciary to act in the best interest of the customer and to provide full and fair disclosure of material facts and conflicts of interest. Today, broker/dealers and investment advisors are regulated by different laws. Generally speaking, brokers are subject to a “suitability standard,” whereas investment advisors are subject to a higher “fiduciary standard.” Concerns have been raised that the differing standard can confuse investors and lead to inconsistent definitions and interpretations under existing law.

Recognizing these inconsistencies, in 2010 Congress adopted Section 913 of the Dodd-Frank Act, which gave the Securities and Exchange Commission (SEC) the authority to adopt a uniform fiduciary standard of conduct for both broker/dealers and investment advisors and directed the SEC to study this issue. Section 913 further gave discretion to the SEC to establish a fiduciary standard. If this standard were created, it would seek to ensure that broker/dealer and investment advisor representatives providing financial services to the public do so under a similar regulatory regime, enforcing a single set of standards regarding the duty to customers.

The SEC staff issued its Study on Investment Advisers and Broker-Dealers in 2011. This study made two recommendations: (1) a uniform fiduciary standard of conduct should be applied to both broker/dealers and investment advisors when they are providing investment advice about securities to retail investors; and (2) in order to enhance investor protection, the SEC should consider harmonizing certain regulatory requirements of broker/dealers and investment advisors.

After the release of this report, progress on developing this new fiduciary standard slowed, and progress stalled for several years. The U.S. Department of Labor (DOL) stepped in by proposing rules, first in 2010 and after withdrawing its first proposal, again in 2015. The DOL’s Conflict of Interest rule, finalized in April 2016, applies a fiduciary standard on all retirement accounts, regardless of whether they are brokerage or investment advisory accounts. This rule added complexity to an already complex issue and in the time since the finalization of this rule, significant debate continued. On March 15, 2018, the Fifth Circuit Court of Appeals vacated the DOL Conflict of Interest rule in toto.

In the meantime, SEC Chairman Jay Clayton has expressed his view that the establishment of a clear fiduciary rule is at the top of the SEC’s priority list. On April 18, 2018, the SEC issued a package of regulatory proposals related to the standards of conduct applicable to investment professionals. The package includes (1) a proposal to enhance the standard of conduct owed by broker-dealers to their clients; (2) a proposal to create a new disclosure form intended to help clients understand the nature of their relationship with their investment professional; and (3) proposed regulatory guidance designed to clarify the fiduciary standard applicable to investment advisers.

Given the lack of clarity as to the future of the DOL rule as well as expected debate around the SEC proposal, state legislatures have begun to step in to fill the void. LPL remains very concerned that broker-dealers and investment advisers are beginning to face divergent standards under various regulatory regimes, including not only from federal regulators like the Department of Labor and the SEC, but also from the 50 states.¹

¹ In addition to the Department of Labor, a number of states have adopted or are presently considering legislation that imposes general fiduciary obligations upon investment activities or require disclosures for non-fiduciary investment recommendation and financial planning relationships. See, e.g., Act Protecting the Interests of Consumers Doing Business with Financial Planners, 2017 Conn. Legis. Serv. P.A.17-120 (H.B. 6992) (enacted July 5, 2017); Financial Planners – Investments – Fiduciary Duties, 2017 Nevada Laws Ch. 322 (S.B. 383) (effective July 1, 2017); 2017 New York Assembly Bill 2464 (introduced Jan. 20, 2017) (relating to mandating
LPL Position

There has been a vigorous public discussion regarding what standards should apply when a financial institution or professional provides investment advice or recommendations to a retail investor. Throughout this debate, LPL strongly supports requiring that investment advice be in the investor’s best interest and has voiced its support for standards that will protect investors by helping to ensure that they receive investment advice and recommendations that are fair and appropriate for their particular investment, savings and financial needs. We also think it is important that financial institutions and professionals provide clear disclosures regarding the nature of their services, their fees and compensation, and material conflicts of interest so that investors can make informed choices about investment services and products.

At the same time, we have urged that such standards and requirements be adopted in a way that preserves investor choice and access to a wide range of investment and financial services. We believe it is critical that the SEC move forward with its own standard of conduct. Doing so will harmonize these standards, reduce investor confusion and costs, facilitate compliance, and promote holistic investment services, advice and planning that will result in better savings and investment outcomes for all Americans, regardless of whether they are saving through a tax-qualified retirement account or a taxable account, and regardless of whether they receive advice from a broker-dealer or an investment adviser.

We applaud the SEC’s efforts to consider, and seek industry perspectives on, adopting a standard of conduct that more broadly protects and serves the interests of all retail investors. As the prudential regulator for broker-dealers and investment advisers, the SEC is best positioned to engineer such a comprehensive rule. Adopting a harmonized standard of conduct for retail accounts is an important exercise of the Commission’s core mission and scope of authority. Further, the SEC has the mechanisms to both adopt and enforce such a standard of conduct, and a clear interest in protecting all retail investors. Finally, it is important for the DOL to coordinate with the SEC, so that compliance with the SEC standard also constitutes compliance with the DOL standard; having two different standards severely complicates the investor experience, and today has led to significantly reduced access to retirement advice.

We will continue to work with the DOL and the SEC on their respective rules while also engaging proactively with state legislatures. In this regard, we emphasize the need for a single standard of conduct; it is untenable for financial advice to be subject to conflicting standards from the DOL, the SEC, the states, and possibly even cities and counties. We need a clear harmonized best interest standard.

We look forward to our continued partnership with Congress, our regulators, and our industry partners to craft such a standard that will work in concert with existing obligations to protect American investors. LPL will continue to push for a thoughtful resolution of this complex issue so that we may end the lingering uncertainty for our advisors and our collective business.

---

2 Letter from David P. Bergers, General Counsel, LPL Financial to U.S. Dep’t of Labor (March 17, 2015) (addressing Proposed Extension of Fiduciary Rule Applicability Date); Letter from David P. Bergers, General Counsel, LPL Financial to U.S. Dep’t of Labor (Jul. 21, 2015) (addressing Proposed Definition of the Term “Fiduciary” and Related Proposed Prohibited Transaction Exemptions); Letter from Stephanie L. Brown, Managing Director, General Counsel, LPL Financial to Elizabeth M. Murphy, Sec’y, U.S. Sec. and Exch. Comm’n (Aug. 30, 2010) (addressing comments on File No. 4-606: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers).