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Harmonizing the Regulation of Financial Advisers

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Abstract
When buying stocks, bonds, mutual funds, and other securities, individuals seeking advice typically turn to broker-dealers or investment advisers before they invest. In many cases, brokers and advisers perform similar functions but they are regulated differently under laws enacted during the Great Depression. Regulators are considering ways to harmonize the regulation of these professionals, but harmonization is fraught with difficulties. This chapter discusses the debate over harmonization and explains how the US Securities and Exchange Commission, the courts, and Congress have responded. The chapter concludes with insights into considerations that will likely determine how the harmonization debate will be resolved.

Keywords
Broker-dealer, investment adviser, securities regulation, financial regulation, fiduciary duty, Dodd-Frank Act, financial regulatory reform, U.S. Securities and Exchange Commission

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Financial services professionals who advise individuals about securities, such as stocks, bonds, or mutual funds, are generally either broker-dealers or investment advisers, titles that have little meaning to ordinary investors (RAND Report, 2008; SEC Staff, 2011*b*; Hung and Yoong, 2013). Although brokers and advisers historically provided distinct services, the roles they serve today are often similar or nearly identical. Regulation, however, has not kept pace with changes in the industry and brokers and advisers remain subject to separate regulatory regimes. The U.S. Securities and Exchange Commission (SEC) is now considering whether to harmonize the regulation of broker-dealers and investment advisers and place a fiduciary duty on brokers that give advice to retail customers. Under a fiduciary standard, brokers would be subject to a higher duty of care applicable to investment advisers. This chapter explores the debate over regulatory harmonization, places it in historical context, and discusses recent developments shaping its resolution.

We proceed by explaining how the debate over harmonization has migrated from the SEC to the courts, to Congress, and back to the SEC. First, we provide background information regarding harmonization, followed by a review of the historical context of the regulation of brokers and advisers, culminating in the SEC's adoption of an ill-fated rule under the Advisers Act to address harmonization-related concerns. Next, we explain the legal challenge to the rule mounted by the Financial Planning Association and the reasons the District of Columbia (DC) Circuit Court of Appeals vacated the rule. Then we turn to Congressional action, summarizing how the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) addressed regulatory harmonization and placed ultimate responsibility for the issue back on the SEC's shoulders. Subsequently, we discuss a 2011 SEC staff study mandated by the Dodd-Frank Act. Finally, we identify challenges facing the SEC as it pursues a path of harmonization.

Regulatory harmonization

Individual investors planning for a child's education, preparing for retirement, or just managing short-term savings, face a dizzying array of financial services providers eagerly seeking to gather more assets under their management. Banks, mutual funds, stockbrokers, investment advisers, insurance brokers, and financial planners of different stripes offer a wide variety of investment products and services, many of which are devilishly complex and beyond the understanding of average investors. In some cases, the roles performed by these service providers overlap. A financial planner who trades securities for a client, for example, must also be a broker-dealer. A securities salesman who also sells insurance policies is subject to the insurance-licensing regime in the state where he does business.

Labels used by financial services providers tend to confound investors. Many individuals and firms which call themselves 'financial advisers' may not be considered 'investment advisers' under the law; instead, they are regulated as broker-dealers. In addition, many brokers and advisers perform an identical function when they provide advice to individuals about securities. Under a philosophy of functional regulation, service providers performing the same role should be treated similarly. The federal securities laws, however, contain separate regulatory schemes, one for brokers and another for advisers, and the duties and obligations differ under each. This result—same function but different regulation—appears nonsensical, particularly when most people pay little attention to whether the individual sitting across the table recommending a stock or mutual fund is considered a broker or an adviser under the law.

What are the key differences between broker-dealer and investment adviser regulation? Brokers are regulated under a Depression-era law, the Securities Exchange Act of 1934, which defines brokers and dealers and requires their registration with the SEC (Securities Exchange Act, 1934: §15(a)). When providing advice to customers, brokers are subject to a 'suitability' standard; they must ensure that investments they recommend are suitable to a customer's investment needs (FINRA, 2012). The theory behind the suitability rule is that when a broker recommends a security, he is making an implied representation that the security is consistent with the investor's objectives and therefore a suitable investment (Hazen, 2009).

Investment advisers are financial services professionals devoted primarily to rendering advice. Advisers are subject to the Investment Advisers Act of 1940, which regulates persons who meet the definition of 'investment adviser' as defined by the Act. Under the Advisers Act, advisers are subject to a higher 'fiduciary' standard of care (*SEC v. Capital Gains Research Bureau*, 1963: 191–2). According to a fiduciary standard, an adviser's recommendation must not only be 'suitable,' it also must be in the client's 'best interest'

(*SEC v. Tambone*, 2008: 146). The adviser's best interest standard is analogous to a fiduciary's best interest standard in other areas, such as the law of trust or guardianship, and the duty has been called the 'highest known to the law' (*Donovan v. Bierwirth*, 1982: 272 n.8).

Over the last 15 years, the SEC has considered whether the bifurcated system of regulation for brokers and advisers should be revisited. During this period, regulators watched in disbelief as Bernard Madoff Investment Securities, which as of 2005 was both an investment adviser registered with the SEC and a broker-dealer registered with the SEC and the Financial Industry Regulatory Authority (FINRA), was exposed as a monumental Ponzi scheme, emphasizing the importance of vigorous regulation of financial services providers (Schapiro Statement, 2009). The courts and Congress have inserted themselves into the harmonization debate, and the Dodd-Frank Act required the SEC to further study the issue. The Act also authorized the SEC to harmonize the law but did not require new rules (Dodd-Frank, 2010: §913).

The decision regarding whether to harmonize regulation is critically important for the legal duties imposed on broker-dealer and investment adviser firms, as well as the hundreds of thousands of registered representatives who work for them, many of whom provide advice to retail customers (SEC Staff, 2011*b*). The decision also has important implications for brokers' business model, which is dependent in certain respects on application of the suitability standard as opposed to a fiduciary norm. Resolution of the debate is also pertinent to regulation of fiduciaries by the US Department of Labor (DOL) under the Employee Retirement Income Security Act (ERISA, 1974). As discussed below, the DOL has proposed a new definition of fiduciary under ERISA. Topics the SEC might address in new rules authorized by Dodd-Frank could apply to ERISA fiduciaries as well (EBSA, 2010).

Securities and Exchange Commission regulation

Historical development

Broker-dealers and investment advisers first faced federal regulation in the early part of the twentieth century when Congress enacted federal securities laws during the Great Depression. The Securities Act of 1933, a seminal securities statute passed as part of Franklin D. Roosevelt's First Hundred Days, required companies offering and selling securities to the public to register offerings with the government and provide detailed disclosure to the purchaser about the issuer and the securities to be sold. The Securities Act, however, did not regulate market professionals, such as brokers or advisers, in any detail.

Regulation of broker-dealers and the establishment of the SEC came one year later in the Securities Exchange Act of 1934. Leading up to passage of the Exchange Act, a bitter clash ensued between the Roosevelt Administration and the brokerage community over matters such as margin requirements, limitations on broker' activities, and the composition of the SEC itself. In the end, the Act was a product of political compromise after intensive lobbying not only by the New York Stock Exchange (NYSE), led by the infamous but formidable Richard Whitney, but also by dozens of local exchanges, which echoed Whitney's concerns. After months of negotiation, Congress passed the Exchange Act, which defined brokers and dealers, placed restrictions on their activities, and required their registration with the newly created SEC (Parrish, 1970; Seligman, 2003).

In 1938, after a scandal ensnaring the NYSE's Richard Whitney, Congress passed the Maloney Act as an amendment to the Exchange Act. The Maloney Act authorized the creation of the National Association of Securities Dealers (NASD) as a self-regulatory organization (SRO) for over-the-counter brokers and dealers (Maloney Act, 1938). Although the NASD played a salutary regulatory role, it also functioned as a powerful trade association and often opposed the SEC's initiatives (Seligman, 2003). The NASD's successor, FINRA, serves today as the SRO for broker-dealers, imposing detailed regulation and registration obligations on broker-dealer firms and their registered representatives. There are now approximately 5,100 broker-dealer firms and 600,000 registered representatives associated with those firms (SEC Staff, 2011*b*).

A statute dedicated to the regulation of investment advisers did not appear until 1940, when the last of the Depression-era securities laws were enacted. On the eve of America's entry into World War II, Congress passed the Investment Company Act, a voluminous statute regulating mutual funds. As Title 2 of the same bill, Congress passed the more modest Investment Advisers Act regulating investment advisers. Unlike the Exchange Act, the Advisers Act contained no reference to a self-regulatory structure for advisers, and no SRO for advisers exists today, although the topic is timely once again (SEC Staff, 2011*a*). The key provisions of the Advisers Act were a registration section, requiring certain advisers to register with the SEC, and an antifraud provision modeled after the Securities Act, which prohibited defrauding advisory clients or potential clients (Advisers Act, 1940: §§203, 206). SEC-registered investment advisers now number approximately 11,000; another 15,000 advisers are regulated by state authorities. There are approximately 275,000 investment adviser representatives associated with advisory firms (SEC Staff, 2011*b*).[1]

The Advisers Act's antifraud provision contained an important section affecting the business models of investment advisers. The provision severely restricted an adviser from engaging in principal transactions with advisory clients. A principal transaction occurs when an adviser, acting as a principal, buys securities from or sells securities to a client. Because principal trading presents a conflict of interest with one's client, the Advisers Act prohibited an adviser from engaging in such trading unless the adviser provided prior written disclosure to the client and obtained her consent on a trade-by-trade basis. When Congress adopted this provision, it clarified that the purpose was to reduce the chance that the adviser would dump a 'sour issue' on its own client (Schenker, 1940). Brokers faced no such restriction in the Exchange Act.

Brokers, who often advise their brokerage customers about securities, were excluded from coverage under the Advisers Act as long two conditions were met. Under the first condition, the broker's advice must be 'solely incidental to' brokerage services. (The phrase 'solely incidental' was not defined.) Under the second, the broker must receive no 'special compensation' for providing advice (Advisers Act, 1940: §202(a)(11)(C)). According to the Act's legislative history, the term 'special compensation' was shorthand for non-commission-based compensation (S. Rep. 76-1775, 1940: 22). Thus, as long as a broker could meet those two conditions—provide advice that is 'solely incidental' to brokerage and charge only commissions—the broker could provide investment advice but steer clear of regulation under the Advisers Act.

For decades, the division between brokers and advisers was fully functional for both regulators and the regulated. Brokers differentiated themselves from advisers by charging commissions. They were regulated under the Exchange Act and subject to a 'suitability' standard enforced by the SEC and the NASD, now FINRA. By contrast, advisers typically charged asset-based fees, such as 100 or 125 basis points, depending on the adviser, the client, and the amount of assets in the account. Advisers were regulated under the Advisers Act and subject to a stricter fiduciary standard of conduct enforced by the SEC. Brokers and advisers seemed to understand what the law required, depending on the type of account at issue, and the law worked fairly effectively and efficiently.

This quiescent state of affairs was disrupted in the 1970s and 1980s when the business model of established brokers came under attack. Deregulation of fixed commissions in 1975 squeezed the profits of many broker-dealers as discount brokers offered inexpensive execution options for customers who did not want to pay for full service brokerage. In addition, financial planning professionals began to offer comprehensive financial planning services to brokerage customers who were interested in advice not only about securities but also about other aspects of their financial lives, such as preparing a will, purchasing insurance, investing in a home, or establishing retirement or college savings accounts (Roper, 2011*a*). As indicated in

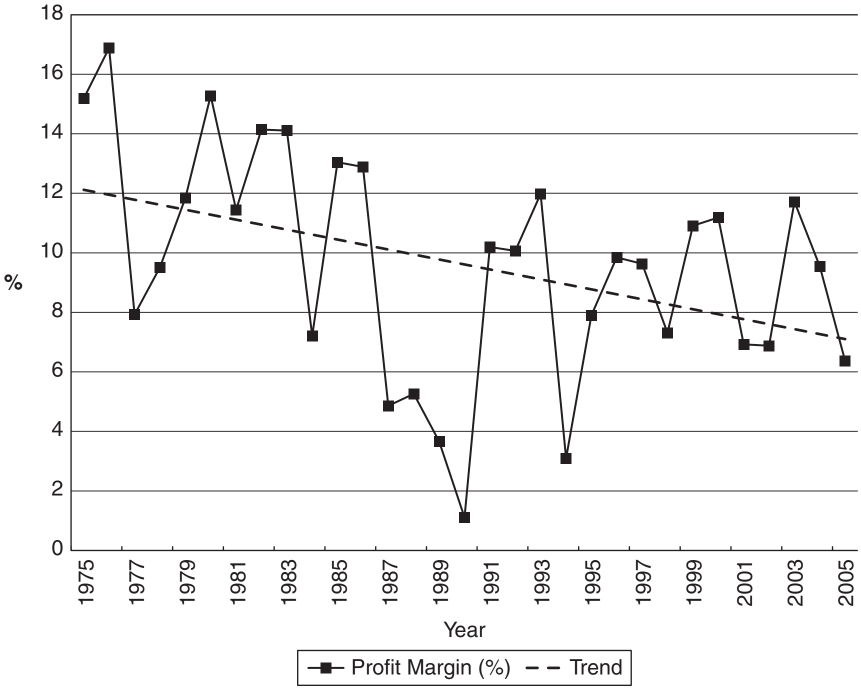

Figure 13.1 Broker-dealers' profit margins (%) from 1975 to 2005

Note: Profit margin defined as the profitability ratio calculated as net income divided by revenues.

Source: SEC (1968–2006) (see Table 13.1).

Figure 13.1, the profitability of broker-dealers declined in the 30-year period beginning in 1975.

Brokers responded to the pressure on profitability in several ways. In the 1980s, some began to offer financial planning services to brokerage customers. In the 1990s, many brokers openly began to market themselves as advisers, even calling themselves financial consultants or financial advisers (Roper, 2011*a*). These brokers marketed their services based largely on trusted advice as opposed to the sale of particular products or traditional brokerage services such as trade execution, custody, recordkeeping, or hypothecation services. Also in the 1990s, to compete with the discount houses, some full service brokerage firms began to offer two tiers of services, one for full service brokerage customers and another for execution-only services (Gordon, 1999).

Finally, many brokers began to migrate from charging commission-based fees to asset-based compensation (White and Ramsey, 1999). This migration was a response, in part, to the publication of the Report of the Tully Committee, led by Daniel P. Tully, then Chairman and CEO of Merrill Lynch & Co. The Tully Committee, appointed to address the negative aspects of 'churning' in customer accounts, concluded that firms should base at least part of their compensation on the amount of assets held in a customer's account, regardless of whether any trading occurs (Tully Report, 1995). An asset-based fee, however, can lead to conflicts of interest as well. When charging an asset-based fee, the firm may pay too little attention to a customer, who must pay the fee regardless of effort expended by the firm, or the firm may fail to recommend that a customer remove assets from an account for the purchase of a product, such as life insurance, that would lower the amount of assets in the account and result in a lower fee for the firm. Nevertheless, after issuance of the Tully Report, many brokers began to charge asset-based fees not only because those fees reduced the risk of churning but also because asset-based fees ensured a constant stream of income for the firm.

The shift from brokers providing traditional brokerage services, such as securities execution, to the provision and marketing of advice, cast doubt on brokers' reliance on the statutory exclusion in the Advisers Act discussed above. If a broker held himself out as a financial adviser, could that broker maintain that his advice was still solely incidental to brokerage? This apprehension was heightened for brokers who charged an asset-based fee. As mentioned, charging any fee other than a commission could disqualify a broker from relying on the exclusion. In addition, introduction of a two-tier fee structure could trigger application of the Advisers Act because regulators could attribute a portion of the higher tier compensation (the difference between the two fees) to investment advice (SEC, 1999). Compensation attributable to advice could be considered 'special compensation' under the Advisers Act, preventing application of the exclusion.

Advisers Act Rule 202(a)(11)-1

By the late 1990s, brokers grew concerned that, as a result of changing their method of compensation, they would become subject to Advisers Act regulation in addition to regulation already imposed under the Exchange Act. In their effort to quell additional regulation, brokers made a policy argument based on a philosophy of functionality. If their activities had not changed, they reasoned, why should they become subject to an additional layer of supervision merely by virtue of offering investors alternative fee structures, particularly when regulators themselves encouraged brokers to adopt those very fee structures to address the pernicious abuse of churning (Gottlieb, 2005)? The SEC agreed in principle with this reasoning and, in 1999, proposed a rule that would allow brokers to charge non-commission-based compensation and still avail themselves of the brokers' exclusion in the Advisers Act (SEC, 1999).

The proposed rule was entitled *Certain Broker-Dealers Deemed Not To Be Investment Advisers*. Under the rule, a broker-dealer who provided investment advice would be excluded from the definition of adviser, regardless of how the broker was compensated, as long as three conditions were met. First, the advice had to be solely incidental to brokerage services. This condition reaffirmed the statutory condition discussed above. Second, the advice had to be non-discretionary. Under this condition, the Commission was stating for the first time that discretionary advisory services could no longer be considered 'solely incidental to' brokerage.[2] Third, the broker had to disclose to its customer that the account was a brokerage account. The last condition was intended to put the customer on notice that although s/he is receiving investment advice, the advice is coming from a broker, not an adviser and, as a result, s/he is not entitled to the statutory protections of the Advisers Act (SEC, 1999).

The Commission received over 1,700 comment letters on the proposal. As expected, brokers generally supported the rule while advisers assailed the initiative for harming investor protection, providing a marketing advantage to brokers over advisers, promoting investor confusion regarding the law, and sending mixed messages regarding functional regulation (Thompson, 2000). The advisers complained that the SEC failed to recognize that the nature of brokers' services changed sharply since 1940 when the Advisers Act was first enacted, and that advice, far from being incidental to brokerage, was now a critical component of brokers' business activities (Thompson, 2000).

The SEC did not act on the rule proposal for several years. In 2004, the Financial Planning Association (FPA), a membership organization for personal financial planning professionals, filed a petition for review of the 1999 proposal. One month later, the SEC reopened the comment period on the proposal, noting that the FPA had raised additional comments (SEC, 2004). In January 2005, the SEC re-proposed the rule in its entirety, making few changes from the original (SEC, 2005*a*). Later in 2005, the SEC adopted the rule as final (SEC, 2005*b*).

When the SEC adopted the rule, it recognized that it did not address some of the troublesome issues raised by the evolving nature of brokerage services. Presaging the difficult debate to come, the Commission, in its adopting release, instructed its staff to consider undertaking a detailed study, which would include the issue of whether broker-dealers who provide investment advice should be subject to fiduciary obligations normally imposed on advisers (SEC, 2005*b*). After the rule was passed, the FPA again petitioned the court for review. The court consolidated the two petitions and issued its decision in March 2007.

Financial Planning Association v. SEC

In its lawsuit, the FPA argued that the SEC exceeded its statutory authority in adopting Advisers Act rule 202(a)(11)-1 (*Financial Planning Ass'n v. SEC*, 2007: 483). In adopting the rule, the SEC relied on exemptive authority contained within the definition of investment adviser. This exemptive authority permits the SEC to exclude from the statute 'other persons not within the intent' of the statutory definition. The FPA argued that reliance on this provision was erroneous because Congress, in 1940, identified elsewhere in the statute the group of brokers it intended to exclude from the statute, namely those brokers whose advice was solely incidental to brokerage and who did not receive special compensation (i.e., non-commission compensation). The exemptive provision, the FPA argued, was inserted to allow the SEC to exclude a wholly different category of advisers from the Act; it was not meant to broaden a category of advisers Congress already addressed in another subsection (*Financial Planning Ass'n v. SEC*, 2007: 487).

Under US administrative law, if the terms of a statute unambiguously preclude an agency's interpretation, the court must reject that interpretation. If the terms are ambiguous, however, the court must defer to the agency's interpretation as long as it is reasonable (*Chevron v. NRDC*, 1984: 842–4). The DC Circuit Court agreed with the FPA that the exemptive provision was unambiguous and rejected the SEC's view. The court stated that the category of brokers the SEC wished to exempt, namely brokers who do charge 'special compensation,' were not *other persons* because the statute already addressed brokers as a category of persons.

Moreover, the court ruled that the SEC's proposed exclusion was not consistent with the intent of the Advisers Act. The statute's legislative history did not support an exclusion broader than the statute itself (*Financial Planning Ass'n v. SEC*, 2007: 488–9). A Senate report explained that brokers were excluded from the definition of adviser insofar as their advice was solely incidental to brokerage and they only charged commissions (S. Rep. 76-1775, 1940). Thus, by excluding brokers who charged other forms of compensation, the SEC's rule conflicted with the statute and legislative history (*Financial Planning Ass'n v. SEC*, 2007: 488). The court granted the FPA's petition and vacated the SEC's rule (*Financial Planning Ass'n v. SEC*, 2007: 493).

Judge Garland prepared a vigorous dissent, explaining that in addition to the ambiguity inherent in the words 'such other persons' and 'within the intent of this paragraph,' the exemptive authority contains a final clause: 'as the Commission may designate by rules.' This language authorizes the SEC, Garland wrote, to determine the intent of the paragraph. Judge Garland simply disagreed that the statute only allowed the SEC to exclude advisers other than those already addressed in the statute (*Financial Planning Ass'n v. SEC*, 2007: 495).

The dissent pointed out that the real ambiguity in the case is whether the authority to exclude 'other persons' means persons other than broker-dealers (the FPA's view) or persons other than the particular broker-dealers covered by the statute (the SEC's view). For the same reasons that Judge Garland found the terms of the exemptive provision ambiguous, he found the SEC's construction reasonable. There is nothing unreasonable about interpreting the words 'other persons' to include persons not actually excluded in the definition itself (*Financial Planning Ass'n v. SEC*, 2007: 498). Judge Garland then moved to the second step of the analysis under administrative law, namely deciding whether the agency's interpretation was reasonable and he found that it was (*Financial Planning Ass'n v. SEC*, 2007: 499–501).

The FPA also argued that the SEC failed to properly analyze the costs and benefits of the proposed rule (FPA, 2007*a*). According to the FPA, when counting benefits, the SEC took into consideration savings by brokers, who, under the rule, could avoid investment adviser regulation. When counting costs, however, the SEC failed to take into account costs that would be imposed on certain investors, who, under the rule, would not receive the benefits of the Advisers Act. In other words, if a benefit of the proposed rule were the resources a broker would save by omitting certain disclosures that were required under the Advisers Act, a concomitant cost of the proposed rule must be the harm imposed on investors who do not receive the disclosure. The SEC responded that it took into consideration costs such as investor confusion and differences in obligations that would follow from the rule (SEC, 2007). The FPA found this inadequate and repeated its earlier attack in subsequent briefing on the issue (FPA, 2007*b*).

Because the court decided the case on statutory authority grounds, it did not address the SEC's cost–benefit analysis. Developments since 2007, however, have placed examination of costs and benefits in the limelight, and the question of costs may determine whether the SEC will once again take up the mantle of harmonization. As discussed below, both industry participants and regulators are now focused primarily on the costs and benefits of additional rulemaking.

Congressional action

The court's decision in the *FPA* case failed to end the debate over the regulation of brokers and advisers; instead, it merely raised additional questions. With the SEC's rule now vacated by the court, lawyers and their brokerage clients puzzled over how to treat fee-based brokerage accounts, which were arguably no longer subject to a valid exclusion and, therefore, covered by the Advisers Act. Moreover, if fee-based brokerage accounts must be treated as advisory accounts, did that mean brokers had to follow the Advisers Act and the SEC rules adopted under the Act with respect to those accounts? If that were the case, the business model of broker-dealers, particularly the ability to enter into principal transactions with customers, would be in question.

One year after the *FPA* case was decided, the RAND Institute for Civil Justice released the SEC-sponsored study referenced in the release adopting the ill-fated rule. A key finding of the RAND Report was that survey respondents and focus group participants did not understand the distinctions between investment advisers and broker-dealers. Investors were confused by the titles these professionals use, the firms they work with, and the services they offer (RAND Report, 2008).

In 2009, the Obama Administration raised the issue of the regulation of brokers and advisers in a white paper on financial regulatory reform entitled *A New Foundation: Rebuilding Financial Supervision and Regulation*. The Administration wrote that, from an investor's perspective, advisers and brokers often provide identical services, yet they are regulated under different statutory frameworks (Treasury, 2009). Echoing the RAND Report, Treasury stated that investors are often confused about the differences between advisers and brokers. Treasury noted that brokers often provide investment advice to clients, and clients may rely on a trusted relationship with their broker. Nevertheless, the fiduciary responsibilities of advisers are not imposed on brokers. As a result, the Administration's position in 2009 was that new legislation should require broker-dealers who provide advice to have the same fiduciary duties as advisers.

The Obama Administration's approach to the problem was the reverse of the SEC's approach ten years earlier. In 1999, the SEC was inclined to liberalize the rules governing broker-dealers, broadening the scope of the brokers' exclusion in the Advisers Act, thereby making it easier for brokers to market and sell their advisory services without adhering to rules placed on investment advisers. By contrast, the Administration sought to tighten the rules governing brokers and treat brokers who provide advice more like investment advisers.

In that spirit, draft legislation prepared by the Senate Banking Committee took an aggressive position that did not prevail in the final bill. The draft language would have struck the broker-dealer exclusion in the Advisers Act in its entirety (Senate Banking Committee, 2009: §913). Under that approach, brokers who give advice would be subject to all regulations imposed on advisers, including the restrictions on principal trading discussed above. Such restrictions imposed on broker-dealers would jeopardize brokers' business model (Laby, 2010). Brokers often sell securities from their own accounts to customers, and they also buy securities for their own accounts from customers, either as a market maker in particular securities or as a market participant seeking to generate trading profits. Engaging in this trading activity is the very definition of dealer in the Exchange Act (Exchange Act, 1934: §3(a)(5)).

Resolving the issue of principal trading is one of the great difficulties in finding a way forward in achieving harmonization. On the one hand, any broker-dealer who provides advice should be required to act in the best interest of the client to whom the advice is given. On the other hand, imposing a fiduciary duty on dealers is inconsistent, or not completely consistent, with the dealer's role. A dealer's profit is earned to the detriment of his trading partner, the very person to whom the dealer would owe a fiduciary obligation. As Norman Poser and James Fanto have explained, when acting as a dealer and selling securities as principal, a broker-dealer firm may be tempted to purchase the securities for a customer's account at a price unduly favorable to the firm; or, when acting as a market maker, the firm may be tempted to unduly pressure a customer to buy securities in which the market maker has a position he would like to dispose of (Poser and Fanto, 2010). Perhaps the real problem is that firms are permitted to act as both brokers and dealers. If this role was split, a fiduciary duty could be imposed on brokers, who would act as agents for buyers and sellers, giving them advice and facilitating the purchase and sale of securities, but not on dealers, who would be permitted to trade with customers for the dealers' own accounts but refrain from providing advice.

In a largely forgotten chapter of the history of securities regulation, this very idea—segregating the roles of brokers and dealers—was discussed, debated, and ultimately abandoned during the dismal days of the Great Depression. When the Securities Exchange Act was debated in Congress, an initial bill included a provision prohibiting brokers from acting as dealers (H.R. 7852, 1934). John T. Flynn, a leading reformer at the time and member of the Senate Banking Committee staff, advocated this position in *The New Republic*: 'I lay it down as a truism that no man whose primary function is a fiduciary one—that of an agent—should be permitted to enter the market in which he appears as an agent for others and to trade in that market for himself' (Flynn, 1936). Proponents of segregation, however, could not overcome industry opposition. Congress struck the provision prohibiting brokers from acting as dealers and instructed the SEC to study the issue (S. Rep. No. 73—1455, 1934). Dealers, however, were not permitted to charge any price they could get away with; charging prices substantially apart from market prices was considered unreasonable and deemed illegal (Duker and Duker, 1939).

The conundrum of how to apply a fiduciary obligation to a dealer which trades with customers out of its own account continues to bedevil Congress and the SEC nearly eighty years later. In a legislative maneuver that parallels Congress' actions in 1934, Congress in 2010 similarly struck the draft provision of Dodd-Frank that would have eliminated the broker-dealer exclusion and which would have imposed a fiduciary duty on broker-dealers who give advice. Instead, as in 1934, Congress required the SEC to study the effectiveness of the existing standard of care for brokers, dealers, and investment advisers when providing advice (Dodd-Frank, 2010: §913(b)).

In addition to requiring a study, Congress authorized, but did not require, the SEC to impose a fiduciary duty on brokers who give advice. In Section 913 of Dodd-Frank, Congress included two rulemaking provisions. Section 913(f) authorizes the SEC to adopt a rule to 'address' the legal standards imposed on brokers and advisers when providing advice. In adopting rules under this section, the SEC must consider the findings, conclusions, and recommendations of the required study. This provision is quite general. The term 'address' is not defined and is arguably limited by existing federal securities laws. This provision does not explicitly hand the SEC the authority to raise the standard of care applicable to broker-dealers (Dodd-Frank, 2010).

The other provision, Section 913(g), is more specific. First, the subsection is entitled, 'Authority to Establish a Fiduciary Duty for Brokers and Dealers.' Second, the subsection amends both the Exchange Act and the Advisers Act to state that the SEC may adopt rules providing that the standard of conduct for brokers and advisers when providing personalized investment advice about securities to retail customers shall be to act in the best interest of the customer—a fiduciary standard. Subsection (g) also provides that the standard of conduct, if adopted, shall be 'no less stringent' than the standard currently applicable to advisers under Section 206 (1) and (2) of the Investment Advisers Act. It is well accepted that the standard applicable under Section 206(1) and (2) is a fiduciary standard (Laby, 2010).[3]

The SEC study on harmonization

The SEC staff published the study required by Dodd-Frank in January 2011.[4] The study contained two principal recommendations, one regarding a uniform fiduciary standard and one regarding regulatory harmonization. As to the first, the staff recommended that the Commission consider adopting a new rule to apply a fiduciary standard uniformly to broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers. Tracking the language of Section 913 of Dodd-Frank, the staff recommended that the fiduciary standard be no less stringent than the standard currently applied to investment advisers under Section 206(1) and (2) of the Advisers Act. According to the SEC staff, the standard of conduct for brokers, dealers, and investment advisers should be to act in the 'best interest' of the customer, without regard to the interests of the broker, dealer, or adviser.

The staff placed responsibility for ironing out the thorny details of implementing a fiduciary standard back on the Commission itself. According to the study, for example, the Commission must ultimately address how broker-dealers should fulfill their fiduciary obligation when engaging in principal trading (SEC Staff, 2011*b*). But such details of implementation are the heart of the problem. Most observers would likely agree that broker-dealers who give advice should owe a fiduciary duty to customers. There is far less agreement over how to implement this change.

Similarly, the staff postponed the difficult question of how to handle conflicts of interest. Should SEC rules prohibit conflicts, require firms to mitigate them, or impose disclosure and consent requirements? (SEC Staff, 2011*b*). Much like Congress declined to tackle the substantive issues and placed responsibility for deciding them on the SEC, the SEC shifted responsibility to its staff to address in the study, then the staff moved responsibility back to the Commission itself. It is no wonder that commentators have used the phrase 'hot potato' to describe the manner in which harmonization has been addressed inside the beltway in Washington (Green, 2011).

As to the second recommendation, harmonization of regulation, the staff suggested several areas where the regulation of brokers and advisers differs and could be brought into accord. Those topics include advertisements, use of solicitors, supervision, licensing and registration, and maintenance of books and records.

The future of harmonization

The future of regulatory harmonization for brokers and advisers will turn on choices and compromises largely unforeseen in 1999 when the SEC first proposed its rule to address fee-based brokerage accounts. The regulatory environment has evolved since the late 1990s. Since that time, investors have witnessed the bursting of the internet bubble in 2000, colossal corporate scandals in 2001 and 2002 such as the failures of Enron and WorldCom, the passage of the Sarbanes-Oxley Act of 2002, the Bernard Madoff Ponzi scheme uncovered in 2008, the financial crisis of 2008 and 2009, and, most recently, passage of the Dodd-Frank Act of 2010. The composition of the Commission has changed as well. Three SEC Chairmen have served between the tenure of Arthur Levitt, who was Chairman in 1999, and the confirmation of Chairman Mary L. Schapiro in 2009. No commissioner governing in 1999 serves today. Thus, the context in which regulators are addressing harmonization is very different from the context in which the SEC's rule was first proposed.

Priorities are different too. In order to gain an understanding of how harmonization might be resolved, one must examine new pressures bearing on the dispute. As a result, we now review three developments essential to understanding the debate over harmonization today. Each of these issues weighs on regulators as they attempt to fashion a solution that is the best for investors and for the markets. The issues are (*a*) whether regulators can quantify the costs of any new rule and satisfy demands for a robust economic analysis; (*b*) whether multiple regulators can work together to find consistent solutions; and (*c*) whether Congress should authorize an SRO for investment advisers akin to FINRA, the SRO for broker-dealers.

Economic justification

The fate of regulatory harmonization for brokers and advisers will likely turn on whether the SEC can justify the initiative in terms of costs and benefits. In their statement regarding the staff study, Commissioners Kathleen L. Casey and Troy A. Paredes criticized the outcome based on an insufficient analysis of the costs and benefits of imposing a uniform fiduciary duty (Casey and Paredes, 2011). They explained that the study failed to identify whether investors are harmed under one regulatory scheme as opposed to the other and accordingly, the staff lacked a basis to conclude that a uniform fiduciary standard would enhance investor protection. Casey and Paredes also called for an analytical and empirical foundation before rewriting the rules governing brokers and advisers. As possible areas of further research, they recommended analyzing investor returns under the two existing regimes, comparing security selections of brokers and advisers, surveying investors, and considering evidence regarding the ability of investors to bring legal claims. The statement by Casey and Paredes was published contemporaneously with the study in January 2011.

In April 2011, the views of Casey and Paredes regarding the necessity of economic analysis were corroborated and validated by a decision of the United States Court of Appeals for the DC Circuit, entitled *Business Roundtable v. SEC* (*Business Roundtable v. SEC*, 2011). In that case, the court overturned Securities Exchange Act Rule 14a-11, a controversial SEC rule, which required public companies to provide shareholders with information about their ability to vote for shareholder-nominated candidates for a board of directors. The basis for the court's decision was the

Commission's failure to adequately consider the rule's effect on efficiency, competition, and capital formation, which is required under the law. When the SEC adopted the rule, Commissioners Casey and Paredes dissented, faulting the SEC for failing to act on the basis of empirical data (Casey, 2010; Paredes, 2010).

In the *Business Roundtable* case, the court punctuated its prose with unblunted criticism of the agency. According to the court, the SEC failed 'once again' to assess the economic effects of a new rule—citing two other examples over the last several years when the same court struck down SEC rules on similar grounds. The court charged the SEC with 'inconsistently and opportunistically' framing the costs and benefits of the rule, with contradicting itself, and with failing to respond to problems raised by commenters (*Business Roundtable v. SEC*, 2011: 7). At one point, the court described an SEC argument regarding use of the rule by mutual funds as an 'unutterably mindless reason' for applying the rule to mutual funds (*Business Roundtable v. SEC*, 2011: 21).

The statements by Commissioners Casey and Paredes regarding the proxy access rule, married with the court's decision in the *Business Roundtable* case, now form the backdrop on which the regulatory harmonization initiative is being sketched. Although the January 2011 statement by Casey and Paredes regarding the SEC's harmonization study predated the *Business Roundtable* decision, once the decision was handed down, all eyes turned to these two commissioners as authoritative regarding the requisite economic analysis for a new SEC rule to withstand scrutiny by the courts. It did not take long for one member of Congress to connect the *Business Roundtable* case with the SEC's harmonization initiative. In a statement delivered at a Congressional hearing examining regulatory oversight of brokers and dealers, Representative Scott Garrett, Chairman of the Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, referred to the SEC's loss on the proxy access rule. He then stated that until the SEC comes forward with a reason, backed up by data, that a uniform fiduciary standard is necessary, the rulemaking should not be under consideration (Garrett, 2011).

The SEC appears to be listening. In a letter to Representative Garrett, SEC Chairman Schapiro described steps the SEC staff is taking to understand available data and evidence as it relates to possible new rules governing brokers and advisers (Schapiro, 2012). Chairman Schapiro recognized the importance of gathering additional data and empirical analysis. She wrote that SEC staff economists were preparing a public request for information to obtain data regarding the market for retail financial advice and regulatory alternatives.

The controversy over the need for an economic analysis of any proposed rule and the ability to perform one is itself becoming politicized. Advocates of a unified fiduciary duty urged members of Congress not to get side-tracked by demands for an extensive economic justification before moving forward. In May 2011, the Consumer Federation of America, a long-time supporter of a unified fiduciary standard, wrote to key members of the House of Representatives asking that a few industry members intent on maintaining the status quo not be allowed to derail a process to provide needed protections to middle-income investors (Roper, 2011*b*). Notwithstanding these statements, there is little doubt based on recent developments, in particular the *Business Roundtable* decision, that the SEC is unlikely to propose a rule to harmonize the regulation of brokers and advisers absent sufficient economic analysis and data demonstrating that the benefits justify the costs or, at a minimum, that the relevant data are unavailable to make that determination.

Retirement plan advisers

In addition to the call for more robust empirical data and economic analysis before the adoption of a fiduciary standard, another development, which could affect any possible SEC rule, is the initiative by the DOL to redefine the term 'fiduciary' for purposes of ERISA (EBSA, 2010). The DOL has overlapping jurisdiction with the SEC because the DOL, under ERISA, regulates advice by financial services professionals to employee benefit plans, participants, and beneficiaries, with respect to plans sponsored by private-sector employers. The debate over the SEC's harmonization initiative parallels an equally vigorous debate over the DOL's initiative to redefine fiduciary as it relates to retirement accounts. Since a key aim of Section 913 of Dodd-Frank is to produce a unified standard governing those who provide individualized investment advice, it is ironic that another agency, the DOL, has proposed to expand the category of persons to whom the ERISA fiduciary standard would apply, including many of the same persons and firms subject to SEC regulation.

The current rule-defining fiduciary under ERISA was adopted in 1975. The rule established a five-part test for determining when an ERISA service provider becomes a fiduciary by virtue of providing advice to an ERISA plan. The five-part test for an adviser without discretionary control contains the following elements: the service provider must (*a*) render advice, (*b*) on a regular basis, (*c*) pursuant to mutual agreement, (*d*) where the advice will serve as the primary basis for investment decisions concerning plan assets, and (*e*) where the advice will be individualized pursuant to the particular needs of the plan (DOL, 2012). The DOL's proposal is intended to adapt the five-part test to current market conditions.

Under the proposed new definition, a service provider generally would become a fiduciary if it rendered investment advice for compensation, whether directly or indirectly, with respect to any plan assets and met one of four additional criteria (EBSA, 2010). The new rule would clarify that the term 'advice' would cover advice to a plan as well as to a plan beneficiary or participant (EBSA, 2010). As a result of the proposed changes, the definition would likely apply to many brokers and advisers who offer advice to clients holding Individual Retirement Accounts (IRAs). The definition is broader than the current rule in other respects as well. It requires neither that advice be provided on a regular basis nor that the parties have a mutual agreement that the advice will serve as a primary basis for the plan's investment decisions. These two criteria have kept the current definition narrow (EBSA, 2010).

Industry representatives are concerned about the divergent tracks followed by the SEC and the DOL. One set of concerns is practical. The DOL's definition of adviser is broader than the Advisers Act definition. It includes a person who provides an appraisal or a fairness opinion concerning the value of securities or other property, which is generally not covered in the Advisers Act (EBSA, 2010). Moreover, an SEC rule governing harmonization would affect services offered by ERISA fiduciaries, such as proprietary trading, compensation, and sales of proprietary products (Financial Services Roundtable, 2011).

Another set of concerns is structural. The SEC and the DOL approach fiduciary norms from different perspectives. According to the SEC, disclosure is often sufficient to address a conflict of interest. The US Supreme Court has written that the Advisers Act reflects a Congressional recognition to eliminate 'or at least to expose' an adviser's conflicts of interest (*SEC v. Capital Gains Research Bureau, Inc.*, 1963: 191). By contrast, the DOL appears to be expanding the definition of fiduciary and prohibiting certain compensatory practices (Financial Services Roundtable, 2011). Without agreement between the agencies, the SEC might permit conduct, if disclosed, that would be prohibited by the DOL. Some have argued that this difference in approach demonstrates the necessity for agreement or coordination (Financial Services Roundtable, 2011).

Dissatisfaction with the DOL's proposed rule prompted leading industry groups, including the American Bankers Association, the Financial Services Roundtable, and the Investment Company Institute, to ask members of Congress to urge the DOL to re-propose the rule and explain how it would be implemented in conjunction with a new SEC fiduciary standard (American Bankers Association, 2011).[5] Shortly after this request was sent, the DOL announced it would withdraw and re-propose the rule. Although the DOL had received significant input in the form of comment letters, hearings, and individual meetings, it stated that it could benefit from additional views (EBSA, 2011). Supporters of the DOL initiative predict that the DOL will not flag regarding this initiative and will propose and adopt an ambitious new rule (Toonkel and Barlyn, 2012).

Those who oppose a broad DOL rule raise cost considerations similar to concerns raised with regard to an SEC rule. A letter to DOL Secretary Solis from 53 members of Congress thanked the DOL for withdrawing the proposed rule and urged it to 'avoid costly new regulations that may reduce choice among qualified service providers and investment products' (Biggert, 2011). Similarly, the President of the National Association of Insurance and Financial Advisors (NAIFA) stated that the DOL should be 'wary of imposing an overly rigid fiduciary rule with unintended consequences that would raise costs and reduce access to advice for millions of middle class retirement savers' (Miller, 2011). To address cost considerations, the DOL has requested data from firms that would be affected by a new fiduciary standard. Industry groups, however, responded that they were unable to provide certain data due to confidentiality concerns, that the data would be costly to provide, and that the request was too broad. The requested data, they said, would not be useful in any case (Bleier et al., 2012). Barbara Roper of the Consumer Federation of America raised the temperature of the debate, asserting that the industry's opposition is ideological and not fact driven (Schoeff, 2012).

Phyllis Borzi, Assistant Director of the DOL's Employee Benefits Security Administration (EBSA), has stated that the laws must be updated to protect workers and retirees and that the new fiduciary standard must cover defined contribution plans such as 401(k) plans (Postal, 2012). The DOL, therefore, appears poised to pursue new rules to redefine 'fiduciary.' At the same time, the DOL is well aware of the SEC's initiatives. Regulators recognize the importance of information sharing and cooperation. When different regulators issue inconsistent positions, it can be just as frustrating for the regulators as it is for the regulated firms, since regulated entities often turn back to the regulators for relief or other assistance when the firms believe they are caught between inconsistent guidelines. Thus, although cooperation might slow the initiatives by both agencies, cooperation is likely to be an important theme before rules by the DOL or the SEC are finalized.

An SRO for investment advisers

In addition to the SEC and the DOL, another organization responsible for regulating investment professionals is FINRA, the SRO for broker-dealers. FINRA, however, does not regulate investment advisers. As discussed, in

1938, the Maloney Act amended the Exchange Act and authorized an SRO for brokers. The Advisers Act, passed just two years later, contained no parallel provision authorizing an SRO for advisers. Whether to place a fiduciary duty on brokers who provide advice is tied closely to an ongoing debate over whether to create an SRO for investment advisers. The SRO question has plagued the SEC for nearly 50 years and Congress once again raised the issue in Dodd-Frank.

In 1963, the SEC's Special Study of the Securities Markets recommended an SRO for advisers (SEC, 1963). The Study concluded that an SRO could 'formulate standards and educate the industry to a higher ethical plane,' and that an SRO would be 'highly desirable.' The Study's recommendation was that registered advisers, other than brokers, should be organized into an official SRO, which would adopt and enforce substantive rules. Alternatively, the Study concluded that the SEC should strengthen its direct regulation of advisers (SEC, 1963).

In 1989, due to growth in the adviser population, the SEC again proposed that Congress provide for the establishment of an SRO (Tittsworth, 2009). Then in 2008, in its blueprint for financial regulatory reform, the Treasury Department echoed these concerns stating that self-regulation by advisers would enhance investor protection and be more efficient than SEC oversight. Treasury recommended that advisers be subject to a self-regulatory scheme similar to the one for broker-dealers (Treasury, 2008). None of these recommendations has resulted in new legislation and the regulatory model has remained unchanged. Brokers are regulated and examined primarily by the NASD, now FINRA, as well as by the SEC; advisers are regulated by the SEC only.[6]

As the number of advisers has continued to grow, some have questioned whether the SEC is up to the task of adviser regulation, including undertaking inspections and examinations (Karmel, 2011). There are approximately 11,000 advisers registered with the SEC, although investor assets are highly concentrated in the top 1 percent of firms (Tittsworth, 2009).[7] This large number of advisers, in light of the relatively meager resources given to the SEC staff, means that advisers rarely undergo examination. In 2011, only 9 percent of registrants were subject to an SEC examination and, on average, SEC-registered advisers are examined once every 11 years. Because this situation appeared untenable, the Dodd-Frank Act required the SEC to address an SRO for advisers in a study, which was completed in January 2011.[8]

The study authors approached the issue in terms of resources and proposed three alternatives: (*a*) authorize the SEC to impose user fees on SEC-registered advisers to fund examinations, (*b*) authorize one or more SROs to examine SEC-registered advisers, or (*c*) authorize FINRA to examine dual registrants for compliance with the Advisers Act (SEC Staff, 2011*a*). Presumably each alternative would require legislation. Consistent with the second alternative, House Financial Services Committee Chairman Spencer Bachus prepared draft legislation that would allow for one or more groups to act as an SRO for advisers.

There is acute disagreement over establishing an SRO for advisers. Advocates point to additional resources for examinations and oversight; consistency between broker and adviser regulation; eliminating the redundancy of two regulatory bodies (FINRA and the SEC) overseeing brokers and advisers, especially a broker and adviser housed under one roof; and an SRO's ability to carry out prudential tasks, such as conducting inspections and examinations, because of a less adversarial relationship between FINRA and the brokerage industry (Ketchum, 2009; Karmel, 2011). Those in opposition point to an extra layer of bureaucracy and cost; conflicts of interest due to industry funding and influence; questions regarding the quality of SRO transparency, accountability, and oversight; historical differences between brokerage and advisory firms; and lack of fit between an SRO model of command-and-control regulation and a diverse adviser community with multifarious business models and a heterogeneous client base (Tittsworth, 2009).

If there is to be an SRO for advisers, FINRA is vying for the job. FINRA maintains it is 'uniquely positioned' to build a strong oversight program for advisers (Ketchum, 2009). Supporters argue this would be efficient because 88 percent of advisers are affiliated with a broker-dealer already overseen by FINRA. The adviser community strongly disagrees that FINRA should be its SRO. In a recent survey, 80 percent of advisers preferred SEC regulation to a FINRA-type SRO for advisers; this preference remained strong even when the cost of SEC oversight exceeded the cost of FINRA oversight (Boston Consulting Group, 2011). Advisers assert that there is a risk, based on FINRA's own statements, that FINRA would attempt simply to export its regulatory structure governing brokers to the world of investment advisers, ignoring the practices and culture of the advisory profession (Tittsworth, 2009).

If cost is a primary consideration, the best solution might not be an SRO. A recent study, sponsored by groups opposing an SRO, concluded that the cost of an SRO model ($550–$610 million annually) is twice as high as the cost to fund a robust SEC examination program ($240–$270 million annually). A new non-FINRA SRO would be even more expensive to administer, $610–$670 million annually (Boston Consulting Group, 2011). Regardless of the cost, resolution of the SRO issue is critical to the harmonization debate, especially if the SRO is to be FINRA, which has been regulating broker-dealers for many years, previously through the NASD, but has little or no experience regulating advisers.

Conclusion

Broker-dealers and investment advisers regularly provide advice and recommendations to investors who often know little about the stocks, bonds, and mutual funds in which they invest. Investors entrust these securities professionals with trillions of dollars of assets, and their futures often depend on the ability of these professionals to meet clients' needs. Notwithstanding the importance placed on financial advisers, most ordinary investors know little about the differences between them. Are they obliged to act in our best interest or merely to determine whether an investment is suitable? Are they selling securities from the firms' own accounts or pairing us with other traders in the market?

Since the 1930s, brokers and advisers have differentiated themselves largely by the way they were compensated. This difference, however, has eroded as brokers have begun to charge asset-based fees, and many brokers now hold themselves out as advisers, causing further confusion as to their roles and responsibilities. As a result, regulators are grappling with proposals to harmonize the regulation of brokers and advisers and place a uniform standard of care on both. Although few would disagree that a uniform standard is a good idea in principle, regulators also must guard against imposing new duties and obligations that would disrupt market liquidity.

The debate over harmonization has evolved since the late 1990s when the SEC first tackled the problem in its proposed rule. The SEC's approach began with a deregulatory philosophy, proposing to expand the brokers' exclusion in the Advisers Act. This initial attempt was vacated by the courts. Congress required further study in the Dodd-Frank Act, and, in its study, the SEC's position seems to have evolved to a more regulatory view, which would impose heightened duties on brokers. Three other developments have transformed the debate over harmonization. When fashioning a proposed rule, the SEC must now be sensitive to increased demands for an empirically based cost–benefit analysis to support the initiative. The SEC must work closely with the DOL, which is seeking to fashion a new fiduciary duty of its own. A DOL rule would likely be applicable to many firms regulated by the SEC. Finally, the SEC must be mindful of calls for an SRO for investment advisers, under which FINRA or a new SRO would be the first-line regulator of advisers, much like FINRA is for brokers. These three developments will shape the politics and the substance of the debate over harmonization in the months and years to come.

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TABLE 13.1 Financial information for broker-dealers (1969–2010) [N]

Year		Pre-tax income ($ millions)	Total revenues ($ millions)	Profit margin (%)
2005	[A]	21,184.10	332,501.10	6.4
2004	[A]	23,188.90	242,929.60	9.5
2003	[A]	25,655.40	218,956.00	11.7
2002	[A]	15,262.00	221,811.00	6.9
2001	[A]	19,396.90	280,095.80	6.9
2000	[B]	39,103.30	349,493.30	11.2
1999	[B]	29,116.30	266,809.40	10.9
1998	[B]	17,184.20	234,964.40	7.3
1997	[B]	19,964.00	207,244.70	9.6
1996	[B]	16,978.50	172,411.50	9.8
1995	[C]	11,325.10	143,414.00	7.9
1994	[C]	3,492.20	112,758.10	3.1
1993	[C]	13,038.60	108,843.70	12.0
1992	[C]	9,116.60	90,584.00	10.1
1991	[D]	8,655.90	84,889.50	10.2
1990	[D]	790.10	71,356.20	1.1
1989	[D]	2,822.90	76,864.00	3.7
1988	[D]	3,477.30	66,100.40	5.3
1987	[E]	3,209.90	66,104.40	4.9
1986	[E]	8,301.20	64,423.80	12.9
1985	[E]	6,502.40	49,844.30	13.0
1984	[E]	2,856.60	39,607.10	7.2
1983	[F]	5,206.80	36,904.10	14.1
1982	[G]	4,073.00	28,801.00	14.1
1981	[H]	2,789.00	24,372.00	11.4
1980	[I]	3,053.00	19,984.00	15.3
1979	[J]	1,652.00	13,957.00	11.8
1978	[K]	1,072.00	11,273.00	9.5
1977	[L]	682.00	8,602.00	7.9
1976	[M]	1,505.00	8,915.00	16.9
1975	[M]	1,120.00	7,373.00	15.2

Notes:
[A]–[E] From 1989 to 2011, the SEC Annual Reports' Pre-tax Income and Total Revenue was consistently recorded for preceding years. However, in *all* Annual Reports, the most recent year (and in some cases, years) was a preliminary projection. Thus, all data from 1984 to 2010 was obtained from SEC Annual Reports in subsequent years where such data was not noted as a preliminary projection.
[E]–[M] From 1975 to 1984, reported data varied from yearly reports due to preliminary projections and revisions. Thus, data was obtained from the most recent SEC Annual Report available which reported the noted year's data.
[N] 'The Commission on June 28, 1968, adopted Rule 17a-10 under the Securities Exchange Act, which requires exchange members and broker-dealers to file annual income and expense reports with the Commission or with a registered self-regulatory organization which will transmit the reports to the Commission. The rule will become effective on January 1, 1969, and the first reports, which will be due in 1970, will cover the calendar year 1969.' See 34 SEC Annual Report 14–15 (1968).

(*Continued*)

TABLE 13.1 Continued

Sources:
[A] Selected SEC and Market Data: Fiscal 2006, Table 7: Unconsolidated Financial Information for Broker-Dealers, at 22 (available at http://sec.gov/about/secstats2006.pdf)
[B] SEC Annual Report: 2001, Table 5: Unconsolidated Financial Information for Broker-Dealers, at 159 (available at http://sec.gov/pdf/annrep01/ar01full.pdf)
[C] SEC Annual Report: 1997, Table 12: Unconsolidated Financial Information for Broker-Dealers, at 192 (available at http://sec.gov/about/annual_report/1997.pdf)
[D] SEC Annual Report: 1993, Table 12: Unconsolidated Financial Information for Broker-Dealers, at 134 (available at http://sec.gov/about/annual_report/1993.pdf)
[E] SEC Annual Report: 1989, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 121 (available at http://sec.gov/about/annual_report/1989.pdf)
[F] SEC Annual Report: 1988, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 131 (available at http://sec.gov/about/annual_report/1988.pdf)
[G] SEC Annual Report: 1987, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 104 (available at http://sec.gov/about/annual_report/1987.pdf)
[H] SEC Annual Report: 1986, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 107 (available at http://www.sec.gov/about/annual_report/1986.pdf)
[I] SEC Annual Report: 1985, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 92 (available at http://www.sec.gov/about/annual_report/1985.pdf)
[J] SEC Annual Report: 1984, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 84 (available at http://www.sec.gov/about/annual_report/1984.pdf)
[K] SEC Annual Report: 1983, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 72 (available at http://www.sec.gov/about/annual_report/1983.pdf)
[L] SEC Annual Report: 1982, Table 1: Unconsolidated Financial Information for Broker-Dealers, at 74 (available at http://www.sec.gov/about/annual_report/1982.pdf)
[M] SEC Annual Report: 1981, Table 1: Financial Information for Broker-Dealers, at 98 (available at http://www.sec.gov/about/annual_report/1981.pdf)

Endnotes

1. Certain firms are dually registered as broker-dealers and investment advisers, and certain individuals are registered as both broker-dealer registered representatives and investment adviser representatives, leading to some overlap in the numbers.
2. Investment discretion is legal authority, similar to authority granted under a power of attorney, to trade on a customer's behalf without obtaining the customer's prior approval (Cox et al., 2009).
3. Section 913(g)(1) amends the Securities Exchange Act to permit the SEC to adopt rules providing that a broker-dealer must comply with the standard of care imposed on advisers under Section 211 of the Advisers Act. In addition, Section 913(g)(2) amends Section 211 of the Advisers Act to give the SEC authority to require that the standard of care for brokers, dealers, and advisers, is to act in their customers' 'best interest.' Section 913(g)(2) also amends Section 211 of the Advisers Act so that the new rules would provide that the

standard of conduct be no less stringent than the standard applicable to advisers under Section 206(1) and (2) of the Advisers Act.

4. The statute required the study to be conducted by the Commission. The January 2011 study was authored by the SEC staff, not the Commission itself, and the study contains a disclaimer stating that the Commission expressed no view regarding the analysis, findings, or conclusion.
5. The other signatories are the Association for Advanced Life Underwriting, the Financial Services Institute, the National Association for Fixed Annuities, the National Association of Insurance and Financial Advisors, the Securities Industry and Financial Markets Association, and the Insured Retirement Institute.
6. The states retain authority to regulate both brokers and advisers in some respects. The scope of state regulation is beyond the scope of this chapter.
7. As of 2008, fewer than 1 percent of advisory firms accounted for more than half of approximately $40 trillion in discretionary assets managed by these advisers (Tittsworth, 2009).
8. This study, issued under Section 914 of Dodd-Frank, should not be confused with the study on the issue of a fiduciary duty for brokers issued under Section 913 of the Act.

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