FINANCIAL SERVICES INDUSTRY TITLES

BACKGROUND

CONSUMER CONFUSION ABOUNDS

It is no secret that, over the years, the brokerage industry has morphed away from the use of the traditional "stockbroker" or "registered representative" titles and toward those titles that emphasize that an advisory relationship exists, such as "financial advisor" or "wealth manager." Hence, it is not surprising that investors are confused about the nature of the services offered by their financial professionals. In survey after survey, consumers have indicated that they do not understand the key distinctions between the duties, services, and compensation models of investment advisers and broker-dealers. Consumers attribute their confusion in large part to the brokers' use of titles such as "financial advisor" and "financial consultant." This confusion is exacerbated by advertisements from broker-dealer firms, such as those that claim:

> "Our Clients' Interests Always Come First"[1]
>
> "Our financial advisors are committed to putting your investing needs, wants and priorities first."[2]
>
> "We address every dimension of your life and your goals—investments, business, passion and legacy—to develop a plan that's truly personalized for you. It's precisely what you need today, and always. Advice. Beyond investing."[3]

THE SEC LONG CAUTIONED BROKER-DEALER FIRMS TO NOT DISGUISE THEIR MERCHANDIZING ROLE

The SEC itself has long been aware that the public is confused by use of misleading titles, including a thorough study of the issue in 2008.[4] As this and many other studies clearly indicate, there is no doubt

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[1] The first "Business Principal" of Goldman Sachs, from their web site, retrieved Dec. 22, 2017.

[2] Merrill Lynch web site, retrieved Dec. 22, 2017.

[3] UBS web site, retrieved Dec. 22, 2017.

[4] In 2008 the RAND Study reported: "Even after being presented with fact sheets, [survey] participants were confused by the different titles. They noted that the common job titles for investment advisers and broker-dealers are so similar that people can easily get confused over the type of professional with which they are working." Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov

that the vast majority of the public has been left confused as to the role of their "financial advisor" – with whom consumers are entrusting their life savings.[5] In fact, in previous decades the SEC strongly cautioned brokerage firms against the use of titles or other forms or promotion or advertising that might mislead investors.

For example, very early on the SEC took a hard line on representations made by brokers. In its 1940 Annual Report, the U.S. Securities and Exchange Commission noted: "If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject' to 'fiduciary duty'. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States Court of Appeals for the District of Columbia in a recently decided case: '[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who would deal at arm's length must stand at arm's length. *And he must do so openly as an adversary, not disguised as confidant and protector*. He cannot commingle his trusteeship with merchandizing on his own account…'"[6] [*Emphasis added.*]

In its 1963 comprehensive report on the securities industry, the SEC also stated that it had "held that where a relationship of trust and confidence has been developed between a broker-dealer and his customer so that the customer relies on his advice, a fiduciary relationship exists, imposing a particular duty to act in the customer's best interests and to disclose any interest the broker-dealer may have in transactions he effects for his customer … *[BD advertising] may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business* … Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties.". [*Emphasis added*.][7]

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of the RAND Corporation, "*Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*," at p.111. This Rand Study was sponsored by the United States Securities and Exchange Commission,

[5] "Many find the standards of care confusing, and are uncertain about the meaning of the various titles and designations used by investment advisers and broker-dealers. Many expect that both investment advisers and broker-dealers are obligated to act in the investors' best interests. The Commission has sponsored studies of investor understanding of the roles, duties and obligations of investment advisers and broker-dealers that similarly reflect confusion by retail investors regarding the roles, titles, and legal obligations of investment advisers and broker-dealers …" SEC Staff, "Study on Investment Advisers and Broker-Dealers (As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act)" (January 2011).

[6] Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, at p. 158, citing *Earll v. Picken* (1940) 113 F. 2d 150.

[7] 1963 SEC Study, citing various SEC Releases.

Yet, and despite the substantial authority already existing (under previous SEC pronouncements, as well as case law), in 2005 the SEC, in the ill-fated "Merrill Lynch Rule" final rule (subsequently overturned by the courts on other grounds), declined to police the use of titles by non-fiduciaries. The SEC stated, in its 2005 issuing release:

> "[W]e share the concern that there is confusion about the differences between broker-dealers and investment advisers, and … we believe that some of that confusion may be a result of broker dealer marketing (including the titles broker-dealers use) …
>
> We have decided not to include in rule 202(a)(11)-1 any other limitations on how a broker-dealer may hold itself out or titles it may employ without complying with the Advisers Act."[8]

In essence, despite acknowledging the consumer confusion and the harm caused thereby, the SEC astounding chose at the time not to act. The SEC may simply have been time-pressed to not fully consider the issue, especially since its non-action directly contradicted its earlier statements. In essence, the SEC appeared to condone a culture of misrepresentation and fraud by broker-dealer firms. This runs contrary to the Investment Advisers Act of 1940, the purpose of which is to "protect consumers and honest investment advisers and to establish fiduciary standards" and the Advisers Act's "more general purpose of preventing fraud and misrepresentation."[9]

Yet, even those at the SEC have continued to note the problems caused by the inappropriate use of titles. In 2012 the SEC Investor Advisor Committee highlighted this problem, stating: "In addition, many broker-dealers use titles such as financial adviser for their registered representatives and market themselves in ways that highlight the advisory aspect of their services … Although they are subtler and more difficult to measure than the harm that results from outright fraud, these types of harm can nonetheless have a significant impact on investors' financial well-being."[10]

UNDER STATE COMMON LAW, THE USE OF TITLES THAT DENOTE A RELATIONSHIP OF TRUST AND CONFIDENCE IS A SIGNIFICANT FACTOR IN FINDING THAT FIDUCIARY STATUS EXISTS

Under state common law, which is not preempted by the SEC's rule-making activities, it has long been recognized that the use of a title denoting an advisory role is a significant factor in determining that fiduciary status exists.

Koehler, 1985. A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal,

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[8] SEC Release No. 34-51523, IA-2376: Certain Broker-Dealers Deemed Not To Be Investment Advisers (Apr. 12, 2005). This rule set forth above, contained in its rule-making (which rule was subsequently overturned by the U.S. Court of Appeals, D.C. Circuit. *Financial Planning Ass'n vs. SEC*, Case No.04-1242 (March 30, 2007), in which the court found: "By seeking to exempt broker-dealers beyond those who receive only brokerage commissions for investment advice, the SEC has promulgated a final rule that is in direct conflict with both the statutory text and the Committee Reports."

[9] *Financial Planning Ass'n vs. SEC*, Case No.04-1242 (March 30, 2007).

[10] "(Draft) Recommendation of the Investor as Purchaser Subcommittee Broker-Dealer Fiduciary Duty," available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation.pdf.

1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, "The developer defendants obtained investment capital from the public by posing as financial planners ... The financial planners typically had a background in either insurance or real estate sales … As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation… CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled … At the seminars, CSCC offered to draft a 'Coordinated Financial Plan' for attendees at little or no charge. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project ...." The court also noted, "Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status."

Cunningham (1990). Insurance agents who introduced themselves as "investment counselors or enrollers" and who tailored retirement plans for each person depending on the individual's financial position, and who led the customers to believe that an investment plan was being drafted for each customer according to each customer's needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).

Mathias (2002). "In the fall of 1985, plaintiff, having recently divorced and relocated to Columbus, Ohio, sought investment advice from Thomas J. Rosser. At the time, Rosser was a licensed salesman for Great Lakes Securities Company and held himself out as a financial advisor … [T]he evidence established that Rosser was a licensed stockbroker and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship." *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002). The court further noted, that under Ohio law, a fiduciary relationship is "a relationship in which one party to the relationship places a special confidence and trust in the integrity and fidelity of the other party to the relationship, and there is a resulting position of superiority or influence, acquired by virtue of the special trust." *Id.*

Williams (2006). In a case arising from Oregon, a self-employed insurance seller and licensed financial planner took advantage of his position as a financial advisor to gain the trust of an 87-year-old man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about $400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a financial advisor and estate planner. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006).

Hatleberg (2005). When a bank held out as either an "investment planner," "financial planner," or "financial advisor," the Wisconsin Supreme Court held that a fiduciary duty may arise in such circumstances. *Hatleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005).

Graben (2007). A dual registrant crossed the line in "holding out" as a financial advisor, and in stating that ongoing advice would be provided, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

The Investment Advisers Act of 1940 is based, in large part, upon the fiduciary principles set forth by state common law. The SEC should not act in a manner that is contrary to state common law, thereby leading broker-dealers and their registered representatives to falsely believe that they will not be held to the fiduciary standard of conduct when they use titles, such as "financial advisor," that denote a relationship of trust and confidence. This is especially so since, in private actions brought against broker-dealers, state common law is the basis for such action, as the Investment Advisers Act of 1940 does not include a general private right of action for consumers.

THE SEC SHOULD ACT TO LIMIT THE USE OF TITLES THAT DENOTE A RELATIONSHIP OF TRUST AND CONFIDENCE TO THOSE WHO ARE HELD TO A FIDUCIARY STANDARD

The "…statutory broker-dealer exception is a recognition by Congress that a broker-dealer's regular activities include offering advice that could bring the broker-dealer within the definition of investment adviser, but which should nonetheless not be covered by the Act.; however, that exemption was narrowly defined as advice "solely incidental to the sale."

As highlighted in the 2008 Rand Study and the 2012 Investment Advisor Committee report "... terms such as ''financial advisor'' and ''financial consultant'' are among the many generic terms that describe what various persons in the financial services industry do, including banks, trust companies, insurance companies, and commodity professionals.", therein lies the problem.

As part of their ongoing business, full service broker-dealers consult with or advise customers as to their finances. Broker-dealers may provide limited advice "solely incidental to the sale;" however, advice on a customer's finances is not remotely incidental. If a financial service provider calls him/her/itself anything relating to an "advisor" or "adviser", common sense says it's impossible to also assert that advice is 'solely incidental' to the sale.

Separate studies by the Public Investors Arbitration Bar Association (PIABA) released in March 2015 "Major Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of A Fiduciary Duty" [1] and by the Consumer Federation of America released in January 2017 "Financial Advisor or Investment Salesperson: Brokers and Insurers Want to Have it Both ways"[2] show that while

many organizations market themselves to the public as trusted 'advisors' or related terms, it is a different story when it comes to defending that position in arbitration hearings. In that context, suddenly they are just salespersons and owe the client no fiduciary duty.

Extensive research has demonstrated that consumers are easily misled by the multitude of titles utilized in the financial services industry. Recognizing that there are two important but distinct and useful service offerings to the general public – brokers subject to the '34 Act and Investment Advisors subject to the '40 Act.

The Investment Advisers Act of 1940 allows an exemption from registration to brokers whose advice is 'solely incidental' to their role as securities brokers. We submit that if one calls oneself an "adviser" or "advisor" or related term, it is contradictory to then assert that advice is solely incidental.

[1] https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf

[2] https://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf