On January 21, 2011, the US Securities and Exchange Commission (SEC) released Study on Investment Advisers and Broker- Dealers, its staff’s study evaluating the standards of care for broker-dealers and investment advisers when providing personalized investment advice and recommendations about securities to retail customers. Mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank, or “the Act”), the study considers the current standards of care and whether there are gaps, shortcomings, or overlaps.

Reiterating conclusions of earlier studies and commentators, the study finds that retail investors generally are not aware of the different regulatory requirements and standards of care governing broker-dealers and investment advisers, or of the legal implications of those duties, and many who are aware find the different standards of care confusing. The study notes that “[i]nvestors have a reasonable expectation that the advice that they are receiving is in their best interest. They should not have to parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations.”

The study concludes that retail investors should be uniformly protected when receiving personalized investment advice or recommendations about securities, and recommends establishing a “uniform fiduciary standard” for investment advisers and broker-dealers, consistent with the standard that currently applies to investment advisers. Notably, the study states that any uniform standard should ensure that retail investors continue to have access to the various fee structures, account options, and types of advice that investment advisers and broker-dealers currently provide. A second part of the study recommends other aspects of broker-dealer/investment adviser rules that could be “harmonized.” This is a study by the SEC staff, and it reflects a significant degree of unanimity among the different offices and divisions participating. However, adopting a uniform fiduciary standard would require proposal of a rule and adoption by the five SEC commissioners. While the SEC has scheduled a rule proposal for between April and July, two commissioners have called for more research and analysis of the issue. In addition, as the study repeatedly states, the SEC would have to provide significant guidance to assist broker-dealers in implementing the uniform standard. Taken together, this indicates that a significant amount of work and debate lie ahead.

Nonetheless, given the study’s call for a uniform standard, firms should immediately begin considering the application of such a standard. This A Closer Look describes the study, as well as some of the implications of its recommendations.

A uniform fiduciary standard

The study recommends that the SEC adopt rules to implement a uniform fiduciary standard for both broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers. That standard would be:

“...to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.”

The uniform standard would be no less stringent than the existing fiduciary standard under Sections 206(1) and (2) of the Investment Advisers Act of 1940 (“Advisers Act”), and would be consistent with the standards and precedent that currently applies to investment advisers. According to the study, the uniform fiduciary standard would be an overlay on top of the existing investment adviser and broker-dealer regimes and would supplement them, not supplant them.

To implement the uniform fiduciary standard, the study recommends that the Commission:

• engage in rulemaking and/or issue interpretive guidance;
• identify specific examples of common material conflicts of interest and provide guidance to facilitate broker-dealers’ transition to the new standard; and
• provide consistent interpretations for broker-dealers and investment advisers.
Studies indicate that disparate standards are confusing to investors, and that investors do not have a clear grasp of their financial adviser’s standard of care, whether they are an investment adviser or a broker. A consistent fiduciary standard may serve to increase not only investors’ certainty but also, potentially, their confidence in their financial advisers. The study also reflects a conclusion that broker-dealers and advisers perform identical or substantially similar functions when providing investment advice to retail investors. Indeed, many broker-dealers have become more focused on providing fee-based financial advice and planning and have moved away from the pure sales-oriented, commission-based model. Nonetheless, the uniform fiduciary standard will likely require that broker-dealers take new steps, as described in this A Closer Look.

**Existing duties of advisers and broker-dealers**

The study includes a lengthy summary of the existing obligations of advisers and broker-dealers, including their duties to retail customers. The broker-dealer regulatory regime is characterized as predominantly a rules-based approach, while the adviser regulatory approach is described as more principles-based.

**Investment advisers.** An adviser is a fiduciary under the Advisers Act, with the “affirmative duty of ‘utmost good faith, and full and fair disclosure of all material facts,’ as well as an affirmative obligation to ‘employ reasonable care to avoid misleading’” clients and prospective clients.\(^2\) The fiduciary duty includes duties of loyalty and care. The duty of loyalty requires an adviser to serve the best interests of its clients, which includes an obligation not to subordinate the clients’ interests to its own.

As part of its fiduciary duty, an adviser must fully disclose to its clients all material information that is intended “to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”\(^3\)

The study summarizes how existing fiduciary principles and guidance have addressed not only conflicts of interest disclosure, but also disclosure of suitability and reasonable basis for investment advice, principal trading and cross trading, best execution, and advertising.

**Broker-dealers.** Under the anti-fraud provisions of the federal securities laws and self-regulatory organization (SRO) rules, broker-dealers are required to deal fairly with their customers. Under the so-called “shingle” theory, by virtue of a broker-dealer “hanging out its shingle” (i.e., engaging in the brokerage profession), that broker-dealer makes an implicit representation to those persons with whom it transacts business that it will deal fairly with them, consistent with the standards of the profession. Actions taken by the broker-dealer that are not fair to the customer must be disclosed in order to make this implied representation of fairness not misleading.

Broker-dealers are also required to “observe high standards of commercial honor and just and equitable principles of trade” under SRO rules.\(^4\) The study summarizes how this obligation addresses conduct in a variety of areas. Among other things, a broker-dealer must:

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\(^3\) Ibid.

• have a reasonable basis for recommendations in light of a customer’s financial situation, to the extent known to the broker (suitability);
• engage in fair and balanced communications with the public;
• provide timely and adequate confirmation of transactions;
• provide account statements;
• disclose conflicts of interest;
• receive fair compensation, both in agency and principal transactions; and
• give customers the opportunity for redress of disputes through arbitration.

**Existing duties compared**

The study makes comparisons in the regulation of advisers and broker-dealers, and draws the following conclusion:

“A core difference . . . is that investment advisers are fiduciaries under the federal securities laws, while broker-dealers generally are not. . . . [T]he fiduciary duty of investment advisers includes a duty of loyalty and a duty of care (encompassing, among other things, a duty of suitability), with the duty of loyalty requiring investment advisers to act in the best interests of clients and to avoid or disclose conflicts. The standard of conduct for broker-dealers has been characterized as primarily to deal fairly with customers and to observe high standards of commercial honor and just and equitable principles of trade, and they also are subject to a number of specific obligations, including a duty of suitability, as well as requirements to disclose certain conflicts. In practice, with broker-dealers, required disclosures of conflicts have been more limited than with advisers and apply at different points in the customer relationship.”

Given this “core difference,” and the staff’s conclusion that investors should have uniform protection when interacting with either type of firm, the study recommends that both broker-dealers and investment advisers should be held to a uniform fiduciary standard in providing personalized investment advice about securities to retail customers.

The comparison is an uneasy one, as the duties and obligations of advisers and broker-dealers have grown up separately through decades of rules and interpretations under of the Securities Exchange Act of 1934 (“Exchange Act”), SRO rules, and the Advisers Act, issued by different divisions of the SEC and by SROs, as well as by courts.

**Implementing the uniform standard**

Quoting Justice Benjamin Cardozo, the study notes that “to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry.”

The study calls for guidance regarding the uniform fiduciary standard and states that guidance should “particularly focus on assisting broker-dealers with complying with the minimum requirements of the uniform fiduciary standard and what it means to generally operate under the uniform fiduciary standard. . . . [T]he Commission should help broker-dealers similarly identify their conflicts of interest as specifically as possible so as to facilitate broker-dealers’ smooth transition to compliance with the uniform fiduciary standard.”
Impact on existing business models and products. With the promise of further guidance to come, the study states that the intent of Dodd-Frank is that the standard of conduct be “business model–neutral”—neither prohibiting, mandating, or promoting particular types of products or business models. The study states the desire to preserve investor choice among services, products, and payment options.

Of note, the study states that while the fiduciary duty requires a firm to eliminate or disclose material conflicts of interest, it does not mandate the absolute elimination of any particular conflicts, absent another requirement to do so. Without elaboration, the study reiterates Dodd-Frank’s guidance on the following:

- **Commission-based compensation.** The Dodd-Frank Act expressly provides that the receipt of commission-based compensation, or other standard compensation, for the sale of securities does not, in and of itself, violate the uniform fiduciary standard as applied to a broker-dealer.

- **Continuing duty.** The Act also provides that the uniform fiduciary standard shall not require broker-dealers to have a continuing duty of care or loyalty to a retail customer after providing personalized investment advice.

- **Proprietary products.** The Act provides that offering only proprietary products by a broker-dealer shall not, in and of itself, violate the uniform fiduciary standard, but may be subject to disclosure and consent requirements.

While the study states that application of the uniform standard will be business model–neutral, it provides no guidance (apart from the literal language of Dodd-Frank) with respect to commission-based compensation, proprietary products, or other matters. If a uniform fiduciary standard is adopted, broker-dealers will need to examine all aspects of their current practices in light of the enhanced standard. They will need to:

- Identify conflicts of interest and potential conflicts of interest, on an ongoing basis, for mitigation, elimination, and/or disclosure. This would include, for example, relationships with mutual fund and other asset management firms, including the payment and receipt of compensation, referral arrangements, and sales incentives, as well as trading and allocations, relationships with affiliates, and other possible areas of conflict.

- Review their broker compensation models and consider any conflicts of interest. While the receipt of commission-based compensation will not “in and of itself” be considered a violation of the fiduciary standard, what role will compensation play in incentivising conduct consistent with a fiduciary role?

- Review the current product mix and determine whether particular products or product features should be dropped or altered. While the sale of only proprietary products or a limited range of products will not “in and of itself” be considered a violation of the fiduciary standard, what will a broker-dealer’s obligation be, if any, with respect to potentially superior products that the firm does not sell? Similarly, how will registered representatives best make recommendations from among the vast array of choices available in a firm with open architecture?

- Consider implications of the fiduciary duty on the model used by some firms, where customers are categorized by investment objectives and risk tolerance and matched with products or product lines, with analysis and matching performed by a centralized group. Who bears the duty? Is the central product selection process meeting fiduciary standards?
Review current disclosures of conflicts of interest with a view toward enhancing disclosure of all conflicts and potential conflicts. Making new “simple and clear” disclosures about conflicts of interest and the terms of relationships would require significant care.

Review the process around product creation and product selection, and consider how it could be affected by a fiduciary model. Additional care would likely be required in product creation and selection, and in consideration of product features.

Create new training for supervisors and registered representatives concerning their new fiduciary obligations. Culturally, this is a shift for those firms and registered representatives that have operated in a sales-oriented environment.

Document recommendations made and the basis for the recommendations, to demonstrate compliance with the fiduciary duty.

Implement revised and new supervisory and compliance procedures, controls, and testing to assure compliance with the uniform standard.

New disclosures

Firm-level disclosure. Both advisers and broker-dealers are currently required to make various disclosures, though the study states that the extent, form, and timing of the disclosures are different. Investment advisers must provide clients and prospective clients with a “brochure” with information about the investment adviser’s services, certain conflicts of interest, and other information, including its range of fees, methods of analysis, investment strategies and their risk of loss, brokerage (including trade aggregation policies and directed brokerage practices, and use of soft dollars), review of accounts, client referrals and other compensation, and the adviser’s disciplinary and financial information. Broker-dealers are not subject to a comparable requirement to disclose conflicts at the time the relationship is established, or provide other information contained in the investment adviser brochure.

Individual representative/associated person level disclosure. Investment advisers must provide clients with a brochure supplement (Part 2B of Form ADV) that includes information about certain advisory personnel upon whom clients rely for investment advice, including their educational background, supervision, disciplinary history, and certain conflicts. The study states that information about persons associated with broker-dealers is available online through FINRA’s BrokerCheck website, though that information is not as extensive as the information provided in the adviser brochure supplement.

“Uniform disclosure.” The study recommends that the Commission consider developing “a uniform approach to disclosure that would provide retail customers of both broker-dealers and investment advisers with relevant key pieces of information at the outset of the advisory or brokerage relationship and at appropriate times thereafter.”

This “uniform disclosure” would have the following features:

- Extending to broker-dealers a requirement of a “general relationship disclosure document” analogous to Form ADV Part 2 at or prior to account opening. A summary disclosure document that would describe in clear, summary form a firm’s services (including the extent to which its advice is limited in time or is continuous and ongoing), charges, and conflicts of interest.
Customers would receive information about the firm’s conflicts of interest, fees, scope of services, and disciplinary information before or at the time of entering into a customer relationship, with annual updating of disclosures thereafter (as is the case with Form ADV Part 2A).

Other disclosures about a product, risks, compensation, or any specific conflicts would be provided when personalized investment advice is given.

The study appears to indicate concern that disclosures could be used to “water down” the uniform standard, and states that the Commission could consider whether rulemaking would be appropriate to prohibit certain conflicts, or where it might be appropriate to impose specific disclosure and consent requirements (e.g., in writing and in a specific format, and at a specific time) in order to better assure that retail customers are fully informed and can understand any material conflicts.

Under the uniform fiduciary standard, advisers and broker-dealers would be required to either eliminate or provide full and fair disclosure of material conflicts of interest. To determine whether to eliminate or disclose, firms will want to:

- conduct a careful review to identify all possible conflicts of interest;
- create an inventory and assess materiality;
- make a determination of whether to eliminate or retain the conflict;
- if retained, create controls to assure that the conflict is mitigated or managed;
- disclose the conflict fully and fairly; and
- repeat the process periodically.

The study confirms that disclosure is at the heart of the fiduciary duty. While noting that the SEC has the authority under Dodd-Frank to prohibit certain sales practices, conflicts of interest, and compensation schemes, it gives little ink to this new authority.

Full and clear disclosure will be critical if firms are to avoid claims that they failed to disclose a conflict and were thus in breach of their fiduciary duty (and to assure that client consent has implicitly been obtained). Firms should reassess existing disclosures in light of the conflict assessment and inventory (described above), fiduciary principles and practice under the Advisers Act, and current regulatory expectations.

According to the study, the uniform fiduciary standard would be an overlay of the existing investment adviser and broker-dealer regimes—supplementing rather than supplanting them. It is unclear how existing guidance and precedent governing advisers would apply to broker-dealers. A recent enforcement case provides insight into the SEC’s expectation of advisers: In September, the SEC charged an investment adviser with securities law violations for switching his clients between two related investments. According to the SEC, while the advisory clients were informed of the total fees they would pay, they were not informed that the switch would increase the commission stream to the adviser. The SEC found that the adviser failed to disclose material conflicts of interest:

“Investors are entitled to understand the fees they are being charged by their advisers and whether any conflicts of interest might be influencing the investment advice they are receiving,” said Marc Fagel, Director of the SEC’s San Francisco Regional Office. “Despite knowing that switching between funds would increase the costs to their clients, [the adviser] did not fully disclose their conflicts in recommending the investment strategy.”

Changes to principal trading

The study describes the different regulatory approaches for broker-dealers and advisers with respect to principal trading: Namely, advisers are prohibited from engaging in a principal trade with an advisory client, unless it provides specific disclosure to the client in writing and obtains the consent of the client to the transaction at or prior to the completion of each transaction. Broker-dealers may engage in principal transactions with customers, subject to a number of requirements, including that they disclose their capacity in the transactions, typically on the confirmation statement after the transaction.

The study concludes that the uniform fiduciary standard would require broker-dealers and investment advisers to provide sufficiently specific facts so that investors are able to understand the conflicts of interest with principal trading. The study notes that the issue is particularly consequential for broker-dealers with respect to fixed-income securities (including municipal bonds), and points out that that broker-dealers and dual registrants had commented that some types of securities, such as municipal and corporate bonds, new issues, and proprietary products, are typically traded and initially offered only on a principal basis.

The study concludes that the Commission should provide guidance on how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading, and consider whether other changes should be made in principal trading requirements. The study states that “under the uniform fiduciary standard, a broker-dealer should be required, at a minimum, to disclose its conflicts of interest related to principal transactions, including its capacity as principal, but it would not necessarily be required to follow the specific notice and consent procedures of Advisers Act Section 206(3).” The study also notes concern with advisers’ requests for consent embedded in voluminous advisory agreements.

The study indicates that the uniform fiduciary standard would not require Advisers Act trade-by-trade disclosure for broker-dealers. More immediately, compliance with principal trading rules is under close scrutiny by the SEC, and firms will want to review their compliance and supervisory programs in this area. In December 2010, the SEC stated that its examiners had identified compliance problems related to principal trading at some dually registered broker-dealers/investment advisers, and that it was making referrals to the Division of Enforcement and continuing to monitor compliance. These problems included:

- non-compliance with principal trading rules;
- weaknesses with compliance monitoring to identify principal trades;
- failing to test the adequacy of compliance programs;
- failing to provide disclosures, or providing disclosures that appeared to be potentially confusing, misleading, or incomplete;
- failing to obtain transaction-by-transaction consent; and
- providing written confirmations that appeared to be potentially confusing or incomplete.

The SEC established a temporary rule allowing an alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the principal trading requirements of the Advisers Act.
Creating minimum standards under the duty of care

The study summarizes the respective duties of care owed by advisers and broker-dealers (as described above) and notes that advisers and broker-dealers commenting on the study argued variously that the duty of care is far more developed for broker-dealers (e.g., standards of conduct developed by FINRA); that the investment advisers’ duty of care is intended to flexibly accommodate the varying structures, sizes, and natures of advisory businesses; and that detailed proscribed rules are inconsistent with the dynamic nature of fiduciary duty.

Without reaching a conclusion, the study recommends that the Commission specify the minimum professional obligations of investment advisers and broker-dealers under the duty of care. The study suggests minimum professional standards with respect to the nature and level of review and analysis that broker-dealers and investment advisers should undertake when making recommendations or otherwise providing advice to retail customers. The study suggests that these minimum standards build on both existing adviser and broker-dealer standards (for instance, with respect to suitability, best execution, and fair pricing and compensation requirements) and advisers’ fiduciary principles (such as the duty to provide suitable investment advice and to seek best execution).

To meet the new standards, firms will likely need to review existing process for making recommendations to customers, particularly when different product choices are available. It is likely that there will be an increase in claims against broker-dealers and financial advisers for breaching their duty of care, and many firms will want to better document the rationale for recommendations, in order to demonstrate compliance with the fiduciary standard, strengthen supervisory oversight, and implement new training programs.

What is “personalized investment advice”?

To provide clarity to broker-dealers, investment advisers, and retail investors, the study recommends that the Commission define and/or interpret “personalized investment advice about securities.” The study concludes that the definition should, at a minimum, encompass the making of a “recommendation,” as developed under applicable broker-dealer regulation, and should not include “impersonal investment advice” as developed under the Advisers Act.

Impersonal investment advice is “investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts.” A recommendation is a communication that constitutes a “call to action” or that “reasonably could influence” the customer to enter into a particular transaction or engage in a particular trading strategy. The study includes examples of recommendations, e.g.:

- customer-specific communications to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a security or engage in a particular trading strategy;
- communications stating that customers should be invested in stocks from a particular sector and urging customers to purchase one or more stocks from a list of “buy” recommendations; and
portfolio analysis tools that generate a specific list of “buy” or “sell” recommendations for a customer based on that customer’s input regarding his or her investment goals and other personalized information.

The study provides helpful information about what a “recommendation” is under current law and appears to signal that current interpretations will be a baseline for future minimum standards. This is an area where firms will want to provide additional comment and input to the SEC.

Firms will also want to ensure that they have inventoried current practices and have a good sense of which meet the definition of “recommendation.” This inventory will be a good starting point for considering the application of the fiduciary standard, as described above.

Who is a “retail customer”?

A “retail customer” is defined in Dodd-Frank as a natural person, or the legal representative of such natural person, who receives personalized investment advice about securities from a broker-dealer or investment adviser, and uses such advice primarily for personal, family, or household purposes. The definition does not differentiate among investors on the basis of their wealth or investment experience.

The study recommends that the Commission (i) provide further guidance, and (ii) specify that personalized investment advice provided to retail customers include both advice to a specific retail customer on a one-on-one basis and advice to a group of retail customers under circumstances in which members of the group reasonably would believe that the advice is intended for them.

The study raises but does not address the question of whether the uniform fiduciary standard should be extended to persons other than retail customers. Dodd-Frank authorizes the Commission to extend the uniform fiduciary standard to “such other customers as the Commission may by rule provide.” Similarly, the study expresses concern about communications with “prospective” customers to the extent that these customers are not “retail customers,” but notes that antifraud provisions apply to “prospective” as well as existing clients and customers.

Additional recommendations to “harmonize” adviser and broker-dealer requirements

A second part of the study contains additional recommendations intended to further “harmonize” the regulation of investment advisers and broker-dealers. The study states that regulatory protections should be the same or substantially similar when advisers and brokers provide similar services. It suggests harmonization regarding (i) advertising and the use of finders/solicitors, (ii) remedies, (iii) supervision, (iv) licensing and registration of firms and individuals, and continuing education, and (v) books and records.

The study states that the Commission could consider these issues as part of the implementation of the uniform fiduciary standard, or as separate initiatives.
**Advertising**

Regarding advertising, the study states that one of the most significant differences between investment adviser and broker-dealer regulation is that, under the Advisers Act and the Exchange Act and FINRA rules, a broker-dealer’s registered principal must approve a communication before distributing it to the public, and certain communications must be filed with FINRA for approval—but, there are no similar pre-use review and regulatory approval requirements for investment adviser communications. In addition, while investment advisers and broker-dealers are subject to similar general prohibitions on misleading or otherwise inappropriate communications, their specific content restrictions differ.

The study recommends that, at a minimum, investment advisers designate employees (such as members of the firm’s compliance department) to review and approve communications before they are distributed to the public. It further recommends that the Commission (i) consider articulating consistent, substantive advertising and customer communication rules and/or guidance for broker-dealers and investment advisers regarding the content of advertisements and other customer communications for similar services; and (ii) consider harmonizing internal pre-use review requirements for investment adviser and broker-dealer advertisements, or requiring investment advisers to designate employees to review and approve advertisements.

**Use of finders/solicitors**

The study notes that the regulation of finders/solicitors differs for investment advisers and broker-dealers. The receipt of transaction-based compensation in exchange for effecting transactions in securities (including soliciting investors) generally requires registration as a broker-dealer. The Advisers Act regulation focuses on disclosure to clients of material conflicts: An investment adviser and a solicitor must enter into a written agreement, requiring the solicitor to provide certain up-front disclosure to prospective clients. In addition, the adviser also has an obligation to supervise the solicitation activities of solicitors.

The study recommends that the Commission review the use of finders/solicitors by investment advisers and broker-dealers, and consider whether to provide additional guidance or harmonize existing regulatory requirements to address the status of finders/solicitors and disclosure requirements, to assure that retail customers better understand the conflicts associated with the solicitor’s/finder’s receipt of compensation for sending a retail customer to an adviser or broker-dealer.

**Remedies**

The study notes differences in the rights and remedies of customers/clients against broker-dealers and against investment advisers. Namely, broker-dealer customers are required by contract with their broker-dealers to arbitrate, while advisory clients are not. Additionally, broker-dealer customers have private rights of action for damages, while advisory clients have a very limited private right of action. Both broker-dealer customers and advisory clients have private rights of action for damages under Exchange Act Section 10(b) and Rule 10b-5 or applicable state law. The study does not recommend that the Commission take any action relating to arbitration as part of these recommendations.
Supervision

The study notes that both broker-dealers and investment advisers are required to supervise persons that act on their behalf, though broker-dealers generally are subject to more specific supervisory requirements. SRO rules explicitly require broker-dealers to, among other things, (i) establish a supervisory system that includes the designation of a supervisory hierarchy, including the assignment of a direct supervisor for each registered representative; (ii) conduct periodic inspections of its supervisory branch offices, non-supervisory branch offices, and unregistered locations; and (iii) supervise the outside business activities and private securities transactions of associated persons.

The requirements for advisers are largely more general and implicit: Advisers and their officers are liable if they fail to supervise associated persons. Additionally, the study’s interpretation of the Advisers Act compliance rule embodies an expectation that an adviser’s compliance processes will include provisions for effective supervision. The study does note an exception to the generally more specific rules for broker-dealers, in that the personal securities trading provisions of the Advisers Act code of ethics rule are more extensive in certain respects than the requirement that broker-dealers supervise private securities transactions.

The study suggests that the Commission consider whether a single set of universally applicable requirements would be appropriate, or, alternatively, whether supervisory structure requirements should be scaled based on the size (e.g., number of employees) and the nature of a broker-dealer or an investment adviser.

Licensing and registration of firms

As the study describes, there are very different licensing and registration requirements for advisers and broker-dealers. Investment advisers register on Form ADV Part 1 and broker-dealers register on Form BD. The study suggests that developing a uniform registration form could reduce some regulatory burdens, but only for dual registrants, who could use a single form to register as both broker-dealers and investment advisers. Currently, only about 600 firms are dually registered with the Commission.

Prior to commencing business, broker-dealers must be cleared by FINRA (or another SRO), which assesses whether (i) the firm and its associated persons are capable of complying with the federal securities laws and observing high standards of commercial honor and just and equitable principles of trade, and (ii) whether the firm has the operational and financial capacity to comply. Investment advisers are not subject to this type of review by the Commission.

The study recommends consideration of whether the disclosure requirements in Form ADV and Form BD should be harmonized where they address similar issues, and suggests that investment advisers should, like broker-dealers, be subject to a substantive review prior to registration.

Licensing and continuing education requirements for persons associated with broker-dealers and investment advisers

The study notes that the broker-dealer regime requires that associated persons be registered with FINRA, disclose their employment and disciplinary histories, and keep that information current. Associated persons who effect securities transactions also pass a
securities qualification exam, and must fulfill continuing education requirements. There is no federal or SRO licensing requirement for investment adviser personnel.

According to the study, the lack of a continuing education requirement and uniform federal licensing requirement for investment adviser representatives may be a gap. It recommends consideration of whether investment adviser representatives should be subject to federal continuing education and licensing requirements. It recognizes the current lack of infrastructure and resources to administer such an education and testing program, but notes that a private organization could develop the program.

**Books and records**

The study notes the differences in the books and records requirements applicable to broker-dealers and investment advisers. Of specific note, the rules for broker-dealers require the retention of all communications received and sent, as well as all written agreements (or copies thereof) relating to a firm’s “business as such.” The rules for advisers require only the retention of materials in specific, enumerated categories. The study concludes that these differences limit the effectiveness of internal supervision and compliance structures and the ability of regulators to access information and verify the entity’s compliance with applicable requirements.

The study recommends that the Commission consider modifying the Advisers Act books and records requirements to include a general requirement to retain all communications and agreements (including electronic communications and agreements) related to an adviser’s “business as such,” consistent with the standard applicable to broker-dealers.

Each of these additional suggestions for “harmonization” presents challenging issues on its own. Many are existing broker-dealer requirements that would be imported to advisers. Given the challenges that each one would present, it is difficult to see how they could be implemented along with the uniform fiduciary standard. Many would be logistically difficult or impossible with current resource challenges and other demands on the SEC—particularly those that, for broker-dealers, are currently performed by an SRO (licensing, continuing education, new member approval process), since no SRO for advisers exists to perform these functions. Other study suggestions, such as harmonizing supervisory requirements and scaling them to the size of the firm, would potentially be easier to accomplish. Nonetheless, in the context of the SEC’s required rulemaking under Dodd-Frank, these appear to be suggestions for the longer term.
While Dodd-Frank will have significant impact on broker-dealers and investment advisers, many implementation issues are currently unclear and are subject to the rulemaking processes and various statutorily directed studies. PwC will continue to monitor developments and provide you with updates, which will be available at www.pwcregulatory.com.

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