Gresham Partners Weighs In On The Fiduciary Standard Debate

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We believe that every firm or individual who offers or provides investment advisory or planning services should be required to register as a Registered Investment Adviser ("RIA") and be held to the existing fiduciary standard of conduct for RIAs, which includes a duty of loyalty, a duty to fully disclose conflicts of interest, and a duty to act in their clients' best interests. We do not support the development of a lower, uniform fiduciary standard that would be applicable to RIAs and brokers.

Background

The investing public is understandably confused about the various standards of conduct, titles, responsibilities and services provided by investment management firms and their employees. This confusion results in significant costs to investors that are avoidable, and is caused in part because most individual investors are unaware of the distinction between an investment adviser and a broker.

With respect to the various standards of conduct, the topic of whether brokers should be held to a fiduciary standard is receiving a lot of attention currently by the Securities and Exchange Commission ("SEC"), the Department of Labor, the President and many organizations that will be impacted by changes to the existing rules. Gresham has been providing investment advisory services to its clients for over 17 years and many of our Principals have been providing these services much longer. Based on that experience, we have some strongly held opinions regarding the fiduciary standard that should apply to firms and individuals who provide or offer to provide investment advisory services to investors.

Gresham's Suggestions

- The SEC should retain primary regulatory responsibility for these firms and individuals;
- Rather than develop new fiduciary rules or adopt a uniform fiduciary standard for investment advisers and brokers, the SEC should simply enforce the Investment Advisers Act of 1940 (the "Advisers Act") and narrowly interpret its "solely incidental" exemption by requiring brokerage firms to register as a Registered Investment Adviser ("RIA") if they hold employees out to the public as advisers through their use of titles or by offering investment advisory or planning services; and,
- The SEC should stop allowing firms to be dual registered as both a RIA and a broker/dealer.

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Overview

Most individual investors are confused about the roles, responsibilities and services of various types of investment services firms, and they don't understand the standards of conduct that are applicable to them and their employees. This confusion and lack of understanding causes avoidable costs to investors that are estimated to be as much as $17 billion annually.[1]

A starting point in the "fiduciary standard debate" is understanding the differences between RIAs and brokers. RIAs and their employees, known as investment adviser representatives or investment advisers[2], provide advice and guidance regarding investments to their clients[3], and are regulated under the Advisers Act. An investment adviser's advice is subject to a fiduciary standard of conduct that includes a duty of loyalty, a duty to fully disclose conflicts of interest, and a duty to act in their clients' best interests.

Brokers engage in the business of buying and selling securities on behalf of their customers[4], are regulated under the Exchange Act of 1934 (the "Exchange Act"), and are currently subject to a much less stringent suitability standard of conduct. In contrast to an investment adviser that must put the investor's interests first, a broker is permitted to recommend investments that put their own interests ahead of the investor's and can suggest investments that may earn them higher fees, even if there are alternatives that have a better combination of risks, expenses and expected returns for the investor.

We welcome the attention that Congress and the SEC, the Department of Labor, and even the President are giving the question of whether brokers should be held to a fiduciary standard. Many investment services firms and the organizations that represent them are also providing input regarding this topic, especially those that would be directly impacted by changes to the existing standards of conduct applicable to brokers and investment advisers. We are pleased to weigh in on the debate regarding what we believe are very important issues for all individuals who seek help with their investments, regardless of whether they are less-affluent retail investors or ultra-wealthy investors. In addition to describing our views below, we have included an Addendum that provides some historical context and a review of the regulatory landscape over the last 80 years that we hope provides further insight to the fiduciary issues being deliberated today.

RIAs vs. Brokers: What is the Difference?

Congress created two separate regulatory acts in recognition that advisers and brokers perform very different functions. Advisers are in the business of providing advice and are compensated by fees that are not tied to whether a transaction is completed. In contrast, brokers are in a sales-based business and are compensated to sell products on a transactional basis.

Congress specifically stipulated in the Advisers Act that if brokers provide investment advice they must register under the Advisers Act, unless that advice is "solely incidental" to their core transactional business. As we will explain, it is this exemption from registration that brokers have used to offer investment advice, yet avoid registration.

[1] *Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates Illusion of a Fiduciary Duty*, March 25, 2015, ("PIABA March 2015 Report") published by the Public Investors Arbitration Bar Association (PIABA). PIABA is a national, not-for-profit association comprised of more than 450 attorneys who dedicate a significant portion of their practice to the representation of public investors in securities arbitration. Gresham has not analyzed the methodology used to produce this estimate, but believes it is indicative of why this confusion should be addressed.

[2] The spelling "adviser" is generally used here rather than the more common spelling "advisor" in order to be consistent with the spelling used in the Investment Advisers Act of 1940.

[3] The term "client" is used when the context indicates an investor working with an adviser subject to a fiduciary standard of conduct.

[4] The term "customer" is used when the context indicates an investor working with a broker/dealer subject to a suitability standard of conduct.

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Brokerage firms internally refer to their brokers as the "salesforce" and "producers", which are accurate terms. Brokers have historically been paid on commission or a percentage of revenue generated from product sales. As is typical in sales roles, brokers are often incentivized by their firms to sell certain products over others, meaning they receive more compensation for selling Mutual Fund A vs. Mutual Fund B, or selling specific bonds, equities, annuities or other investments. Historically, brokerage firms have issued their brokers a "payout grid" which lists the various products they are able to offer to customers and the commission the broker receives from each sale. Regardless of the title used on their business cards, brokers focused on selling products are viewed by the brokerage firms that employ them, as well as the Exchange Act, as transaction-based salespeople.

A Wolf in Sheep's Clothing?

There is nothing improper about brokerage firms incentivizing their brokers to recommend and sell certain products. However, most investors do not fully understand the role that brokers play, how they are compensated, and that they may have a conflict of interest by recommending an investment that earns them higher fees, even if there are better alternatives for the investor. Unfortunately, it seems that many brokers realized years ago that it is easier to sell products to investors who think they are being provided investment advice rather than being sold investment products.

For many years we have observed that brokers have used titles such as Financial Advisor or Financial Consultant on their business cards, and more recently some brokerage firms also began to advertise their ability to help investors answer their financial planning questions. Today, we see many brokers holding themselves out in ways that imply they are advisers, with marketing designed to suggest that they are working with their customer as a fiduciary, but they strongly deny any such fiduciary liability exists if they are sued or accused of providing conflicted advice that results in investor losses.[5]

How did this happen? We believe the "solely incidental" exemption under the Advisers Act, as described above, has not been strenuously enforced, allowing brokers to exploit that exemption to their advantage and engage in what we would describe as "deceptive practices."

Adding to investor confusion, many – and especially larger – financial services firms operate as both a broker and a RIA (known as a "dual registrant"), with many employees acting as an adviser subject to the fiduciary standard and the same or other employees acting as a broker subject to the suitability standard, sometimes for the same investor. Regardless of the disclosures used by such dual registrants, we do not believe it is possible to adequately inform investors so that they can understand when and how two different standards of conduct apply to services being provided to them by one individual or firm.

A Fiduciary Standard is a Mindset, Not Just a Regulatory Construct

Gresham Partners, LLC is a RIA and we have elected to operate our business in a manner that minimizes conflicts of interest and maximizes transparency with our clients, as we serve them as a fiduciary dedicated to their best interests. We think this approach is essential to forming a relationship based on trust. We believe that it is difficult to teach people to put their client's interest ahead of their own – and it may be impossible to do so with those who are compensated as salespeople. It is our experience that people either inherently subscribe to the principle that their clients' interests come first, or they don't.

[5] See PIABA March 2015 Report, pages 1-2.

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There is ample evidence that larger brokerage firms fail to put their customers' or clients' interests first. This probably should not be surprising in a brokerage firm culture driven by sales metrics and where the firm's executive management views their brokers as producers. To paraphrase a quote from Upton Sinclair:

"It is difficult to get a man to understand something when his livelihood depends upon his not understanding it."

Here are a few examples from just the past two years of brokerage firms and other financial institutions improperly putting their interests ahead of their customers':

- In March 2015, one of Wall Street's largest brokerage firms (a dual registrant) was fined $2.5 million by the State of Massachusetts for violating its own compliance policies when it provided 300 brokers in Boston with training presentations that included ways for them to "double production" by transferring existing customer assets from commission-based brokerage accounts to fiduciary fee-based alternatives.[6]

- In June 2014, this same firm was fined $8 million by FINRA[7] and ordered to repay $89 million to certain small business retirement accounts and charities for overcharging various mutual fund upfront sales charges; the firm learned of the over charges in 2006, but it continued the practice and failed to report the problem to its regulator for more than five years.

- In December 2014, FINRA fined ten of the largest brokerage firms (many of them dual registrants) a total of $43.5 million for allowing equity research analysts to solicit investment banking business in exchange for a promise to offer favorable research coverage in connection with initial public offerings of stock to be sold to investors.

- In February 2014, a major brokerage firm (a dual registrant) was fined $196 million by the SEC for allowing their overseas relationship managers to provide broker-dealer and investment advisory services over a seven-year period to thousands of clients in the U.S. without first registering with the SEC.[8]

- On May 20, 2015, five large financial services firms, many of them dual registrants with brokerage and wealth management divisions, agreed to pay $5.6 billion in combined fines and plead guilty to criminal charges with the U.S. Justice Department related to rigging foreign currency exchange rates to benefit their own positions, at times to the detriment of their customers. The fines, which include penalties from the Federal Reserve and other regulators, are in addition to a combined $4.3 billion many of the same banks paid in November 2014 to resolve similar charges from U.S. and U.K. regulators. One way the firms knowingly misled their customers about the price of currencies, according to federal and state authorities, was by imposing "hard markups," which one of the firm's employees described as the "worst price I can put on this where the customer's decision to trade with me or give me future business doesn't change." [9]

Dodd-Frank Grants the SEC Additional Powers and Makes Changes to the Exchange and Advisers Acts

The fiduciary duty debate has been on the SEC's agenda for many years. After the 2008-2009 stock market plunge and related mortgage-industry crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in 2010. Dodd-Frank was an attempt to address investor confusion and it encouraged – but did not require – the SEC to consider "harmonizing" the separate standards of conduct and adopt uniform rules applicable to brokers and RIAs.

[6] Wall Street Journal, March 23, 2015.

[7] The Financial Industry Regulatory Authority (FINRA) is the brokerage industry's self-regulatory organization for all securities firms doing business in the United States.

[8] U.S. SEC Press Release, 2014-39, Feb. 21, 2014.

[9] New York Times, "Rigging of Foreign Exchange Market Makes Felons of Top Banks", May 21, 2015.

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Brokerage firms were quite concerned about having their brokers be subject to the same fiduciary duty that currently exists for RIAs and they lobbied hard to ensure this did not occur. Congress accommodated many of their requests. First, to preserve the brokers' traditional business and revenue model, Congress included language in Dodd-Frank stating that compensation based on commissions would not itself be considered a violation of the prescribed fiduciary standard. Additionally, Congress stipulated that any fiduciary rule that may be applied to brokers would make it clear that they did not have a "continuing duty of care or loyalty" to the customer after providing personalized investment advice. This second concession constitutes a major change to the existing fiduciary standard that applies to RIAs and it would significantly reduce investor protections.

Dodd-Frank required that the SEC perform a study and issue a report before moving forward with any rule changes, which it did in 2011. In March 2013, the SEC issued a request for comments regarding potential harmonization of investment adviser and broker-dealer regulation, which would include adopting a uniform fiduciary standard of conduct. The comment period for that SEC request closed on July 5, 2013. The Chair of the SEC, Mary Jo White, publicly announced in March 2015 that the SEC will make addressing these issues a priority, but it had not made any further announcements as of June 15, 2015.

The Department of Labor Proposes Rules Expanding Fiduciary Duties for Retirement Investment Advice

Rules governing investment advice provided to participants in retirement plans are overseen by the Department of Labor ("DOL") and they are independent of the SEC's rules applicable to RIAs and brokers. The DOL's current rules applicable to retirement investment advice are narrow in scope, but they impose extensive fiduciary duties on parties that provide certain services to retirement plans and their participants.

Because the SEC had not acted to implement its powers under Dodd-Frank and recognizing that many retail investors have a significant portion of their wealth held in qualified retirement plans, in February 2015 President Obama called on DOL to move forward with proposals to expand fiduciary duties applicable to retirement investment advice. DOL drafted and released its proposed rule changes on April 14, 2015, for a 75-day notice and public comment period, which was subsequently extended for an additional 15 days.

DOL's proposed rules significantly expand the types of retirement investment advice that are covered by fiduciary protections. Subject to certain exemptions, they specify that an individual who receives compensation for providing advice that is individualized or specifically directed to a retirement plan participant or to an individual retirement account ("IRA") owner for consideration in making a retirement investment decision is a fiduciary.[10]

Not surprisingly, this proposed expansion of investor protection is being met with resistance from most brokerage firms. In contrast, RIAs are not likely to be particularly concerned about the proposed rules, unless it seems that DOL will impose reporting or other requirements for RIAs that are contrary or in addition to those already imposed by the SEC. The proposals are still being studied; they probably will be revised before being finalized; and, it likely will be several months before some version of them becomes effective.

[10] The Supreme Court held recently in *Tibble v. Edison International*, No. 13-550 (May 18, 2015), that an ERISA fiduciary has an ongoing duty to monitor plan investments. This ruling may be at odds with some aspects of DOL's proposed rules, which were issued prior to that ruling, and it also may impact the SEC's approach to proposing a uniform fiduciary standard of conduct for investment advisers and broker-dealers.

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Is Applying a Fiduciary Standard to Brokers the Answer?

We support efforts of the SEC and DOL to address investor confusion and agree that something should be done to change current sales practices in the financial services industry. However, we do not believe that applying a uniform fiduciary standard to RIAs and brokers is the optimal choice for three reasons.

- First, brokers and advisers have different business models, provide different services, and are subject to different statutes and regulatory structures. Advisers provide their clients with advice and guidance on a broad range of topics, are paid for these services even when transactions are not implemented, and are subject to a principles-based set of rules. Brokers sell and implement specific transactions, are paid when transactions are executed, and are subject to detailed rules designed to simultaneously provide necessary protections for their customers and allow them to operate as salespeople and effect transactions.

- Second, to apply a uniform fiduciary rule under the Exchange and Advisers Acts would require the adoption of a lower fiduciary standard than applies to RIAs today, due to the requirement of Dodd-Frank that brokers not be subjected to a continuing duty of care or loyalty after providing investment advice. Such a change would reduce protections currently provided to RIA clients, which seems like a bad idea and is inconsistent with the approach taken by DOL in its proposed rules.

- Third, Dodd-Frank would require that a uniform standard allow brokers to receive commissions as payment for their advice. It should not be necessary to absolutely prohibit receipt of commissions as payment for advice, so long as that compensation form is disclosed as completely and clearly as fees that may be charged for the same services. We would observe, however, that it may be unrealistic to expect brokers to serve as fiduciaries who act in their client's best interests, yet are compensated only upon completion of transactions in a manner that varies depending on the characteristics of the transaction.

We agree with the spirit of DOL's proposed approach that holds individuals and firms to a fiduciary standard when providing investment advice to retirement plan participants and IRA owners. That said, for its approach to be workable, DOL's implementation will need to be compatible with the SEC's approach for regulating the same individuals and firms when they provide that advice.

Gresham's Solution to the Fiduciary Standard Debate

We appreciate that strong external pressures are being exerted on the SEC by parties with vested interests in preserving the confusing and harmful status quo or, if necessary, being subjected to a watered down fiduciary standard. However, we believe the SEC's primary responsibility with regard to the fiduciary standard topic is to protect the interests of individual investors – not the firms that provide them investment advice and sell them investment products – and that all such investors would benefit from the SEC expeditiously addressing this topic now.

Rather than develop new fiduciary rules or adopt a uniform fiduciary standard, our preferred approach would be for the SEC to simply enforce the Advisers Act, as it was enacted by Congress in 1940, and narrowly interpret its "solely incidental" exemption so that brokerage firms must register as RIAs if they hold their employees out to the public as advisers through their use of titles, such as "Financial Adviser", or by marketing and providing investment advisory or planning services.

In our view, the concept of dual registrants as it is employed today should be eliminated so that one firm cannot provide both Exchange Act and Advisers Act services to the same client. Due to the complexity of most investment services and products, it is our opinion that disclosures cannot adequately inform investors so they can understand when and how two different standards of conduct apply to services that might be provided to them by the same firm, much less by the same person.

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Addendum: What Led to the Fiduciary Standard Debate?

A Tangled Web of Titles

We believe a confusing variety of titles are used by individuals and firms that offer to help the full range of individual investors, from less-affluent retail investors to ultra-wealthy investors. These titles tend to combine a word like investment, financial, wealth or retirement with a word like planner, adviser or consultant. Interestingly, the term broker or dealer is almost never included. Certain designations, like CERTIFIED FINANCIAL PLANNER™, require specialized training and certification by a self-regulatory organization, but more generic titles require no such training or certification.

Regardless of the title used, securities laws generally classify these individuals into two categories: Brokers, who technically are "registered representatives" working for a "broker-dealer" ("B/D") firm serving customers, and "investment adviser representatives" working for a RIA firm serving clients. Much of the confusion today results from the fact that the same firm can be both a B/D and a RIA, with its employees acting as both a broker and an investment adviser representative, sometimes for the same investor who may be both a customer and a client.

The Exchange Act regulates B/Ds and their registered representatives, who are defined as "any person engaged in the business of effecting transactions in securities for the account of others." Industry regulations further provide that a B/D is a person or company in the business of buying and selling securities on behalf of its customers (as a broker) or for its own account (as a dealer), or both. B/Ds are overseen by the SEC and most are members of a self-regulatory organization named the Financial Industry Regulatory Authority ("FINRA").

B/Ds and their registered representatives are compensated generally when a transaction is consummated by a commission, which may be a flat amount from a schedule of charges or a percentage of the value of the transaction, or a spread, which is the difference between the amount the buyer paid and the seller received as a result of the transaction. Both approaches are typical for business activities where someone facilitates a transaction and is not acting in a fiduciary capacity.

The Advisers Act regulates RIAs and their registered investment advisers, who are defined as "a person or firm that, for compensation, is engaged in the act of providing advice, making recommendations, issuing reports or furnishing analyses on securities, either directly or through publications." RIAs are registered and regulated by either the SEC or their appropriate state securities regulator, depending on the amount of assets they manage.

RIAs and their registered investment advisers are compensated generally by fees that are calculated on the amount of assets under their management or on which they advise, fees that reflect their expertise and the amount of time they spend providing advice, a flat fee that reflects the services they provide, a performance fee that reflects the absolute or relative (to some benchmark) performance of assets they manage, or a combination of these approaches. These compensation approaches are typical for advisory services where compensation is not contingent on the consummation of a transaction.

RIAs may also receive compensation in the form of "soft dollars", which is a term used to describe research, education and other services provided by brokerage firms and other providers of services to the RIAs. Although these compensation approaches certainly can produce conflicts of interest between the adviser and the client, the adviser is required to act in a fiduciary capacity, including the duty to disclose all conflicts of interest. B/Ds and their registered representatives have no such requirement or duty.

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The Historical Landscape

For many years, B/Ds only provided advice that was incidentally part of their B/D services, for which clients paid fixed commissions or spreads. Shortly after World War I, some B/Ds began offering investment advice for a specific fee through separate research departments in their firms. Over time, registered representatives, subject to the Exchange Act, began to use this research as support in their traditional brokerage business for which they received fixed commissions from customers.

As the U.S. economy and markets recovered from the Great Depression, Congress became concerned that investors were receiving investment advice from unregulated sources and it was difficult to distinguish reputable investment counselors from "tipsters." After studying the issue for several years, Congress decided it needed to regulate people providing investment advice so it enacted the Exchange Act in 1934 and then the Advisers Act in 1940.

The definition of an "investment adviser" under the Advisers Act was purposefully left quite broad. Recognizing that this definition captured several advisory activities that were already subject to regulation under the Exchange Act or other laws, the Advisers Act contained several exemptions for people providing those services so they would not have to register as a RIA. These exemptions include "any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession." Certain banks as well as publishers of newspapers and magazines are also excluded. Of particular note, the Act also exempts any "broker or dealer whose performance of such [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation thereof."

This last Advisers Act exemption was recognition by Congress that B/Ds may offer investment advice both as a part of their traditional transaction business of buying and selling securities to customers and for a separate fee through a research department to clients. The SEC has construed this B/D exemption under the Advisers Act to apply only when a B/D offers advice as an ancillary part of its traditional transaction business, and to not apply when a B/D charges a separate fee for investment advice.

When a firm offers both B/D services and non-exempt investment advisory services, employees who act sometimes as a registered representative and sometimes as an investment adviser representative are subject to both the Exchange Act and the Advisers Act, and are referred to as "dual registrants." When someone who is a dual registrant is acting in both capacities for the same investor, it can be difficult for that investor to fully understand which services are being provided pursuant to which Act.

Separate Standards of Care

By design, the Advisers Act made a distinction between advice and sales. For many years, it was clear that brokers sold securities as salespeople to customers for a commission or spread on a transaction basis. In contrast, advisers provided advice for a fee and, as a counselor, often stood in a position of trust with their clients. These were two very different businesses, and both Congress and the courts recognized this by holding the parties to different standards.

The Exchange Act includes a general prohibition against fraud and over the years the SEC and FINRA have established a code of conduct applicable to B/Ds that includes duties to deal fairly with customers and to

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make a suitability determination prior to offering an investment to a customer. In summary, a B/D must have a reasonable basis to make a recommendation to a customer based on the surrounding facts and circumstances. However, a B/D is permitted to recommend investments that put their own interests ahead of their customers, and can suggest investments that may earn higher fees for them, even if there are alternatives that have a better combination of risks, fees and expected returns. Importantly, under the Exchange Act, a B/D and its brokers do not have a duty to disclose that they may have a conflict of interest with their customer.

Congress understood that Advisers counseling clients needed to be held to something more stringent than the brokers' suitability standard. The Advisers Act prohibits conduct by an RIA that is manipulative, fraudulent or deceitful, and the Supreme Court and the SEC have interpreted the law to establish a fiduciary duty between a RIA and its clients, which is a much higher standard than the suitability rules under the Exchange Act. As a result, a RIA and its investment adviser representatives have several responsibilities, including the following duties: (i) loyalty; (ii) disclosure; (iii) to determine suitability of the investment and to inquire as to the client's goals and financial situation; and, (iv) to not engage in conflicts of interest, unless they are disclosed.

The Evolution of Advice and Transactions

The brokerage industry began to change in the 1980s and 1990s as discount brokers and electronic trading drove down trading commissions and, as a result, B/D revenues. Mutual funds became widely used and a new process known as "financial planning" became more prevalent. In an attempt to diminish churning of customer accounts and to align the B/Ds' interests more closely with their customers, in 1999 the SEC issued a proposed rule exempting fee-based brokerage accounts (called "fees-in-lieu of commissions" accounts) from the Advisers Act. At the same time, the SEC granted what amounted to a "no-action letter" stating that it would not pursue enforcement cases under the Advisers Act against B/Ds using these fee-based accounts. Under this exemption, brokers could charge their customers fees instead of commissions and not be subjected to the Adviser Act's fiduciary standard.

Advisers whose fee-based accounts were subject to the Advisers Act, objected to the SEC decision and asserted this fee-in-lieu of commission was "special compensation" that triggered registration for B/Ds under the Advisers Act. The SEC did nothing further with the proposed rule for five years, and then the advisory industry – through the Financial Planning Association ("FPA") – filed a lawsuit against the SEC in 2004 asserting that it had overstepped its bounds with the proposed exemption.

In response to the FPA lawsuit, the SEC made some revisions and re-proposed the rule, issuing a final version in April 2005. The FPA pushed forward with its lawsuit, however, and in 2007 a federal court ruled against the SEC, holding that had Congress wanted to make an exemption to the Advisers Act for fee-based accounts, it would have done so. The SEC did not appeal the court's ruling, causing brokerage firms using the fee-based accounts to convert these to their advisory platforms, thus subjecting them to the Advisers Act. As a result, the number of B/Ds filing as dual registrants with the SEC increased substantially.

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Unintended Consequences of the FPA Lawsuit

The focus of the FPA lawsuit was whether the fee-in-lieu of commission accounts involved "special compensation" under the Advisers Act. However, the SEC rule that was struck down by the federal court, titled "Certain Broker Dealers Deemed Not To Be Investment Advisers", contained several other provisions and clarifying rules regarding B/D activities.

The SEC rule's preamble recognized that the brokerage business had evolved since 1940, and the rule contained significant provisions regarding the SEC's interpretation of "solely incidental" and the B/D exemption in the Advisers Act. For example, the SEC recognized that registered representatives' usage of titles such as "Financial Adviser" could be confusing to the public.

It also recognized that while B/Ds had always provided ancillary advice as part of their traditional brokerage model and some elements of financial planning should be a part of the B/Ds' considerations in making a suitability determination for customers, some B/Ds were promoting financial planning as a way of acquiring investors' confidence and then offering brokerage services without any meaningful planning services. As part of the rule, the SEC said it would rely primarily on how a B/D holds itself out to the public and customers in determining whether advice is "solely incidental." It included what was essentially a bright line test: If the B/D portrayed itself to the public as a financial planner or delivered a financial plan to the investor, then the B/D would be subject to the Advisers Act with respect to those clients.

Unfortunately, the SEC rule did not contain any severability provisions, so when the FPA won its lawsuit, all of the provisions in the rule were vacated. There has been little guidance from the SEC since this federal court decision with respect to the "solely incidental" exemption despite the significant growth of the B/D industry over the last ten years. This growth has led to more dual registrant filings, whereby companies and individuals are providing both brokerage and advisory services concurrently, often to the same client. This situation results in confusion among investors who typically make no distinction between B/Ds and investment advisers and are often unaware of the different legal standards that apply to the advice and recommendations they receive from B/Ds and investment advisers, or that B/Ds may have a conflict of interest regarding the solutions they are providing.

Dodd-Frank, Harmonization and the Fiduciary Standard

Congress passed Dodd-Frank in 2010, which amended the Exchange Act to authorize, but not mandate, the SEC to promulgate rules to impose a new standard of care on B/Ds consistent with the fiduciary duty applicable to advisers under the Advisers Act. To preserve the B/D's traditional business and revenue model, Congress included language to clarify that compensation based on commissions would not itself be considered a violation of the prescribed fiduciary standard, and that brokers would not have a "continuing duty of care or loyalty" to the customer after providing personalized investment advice.

Dodd-Frank also created a new section of the Advisers Act that deals with Standards of Conduct for retail investors. This section authorized, but did not require, the SEC to adopt rules to provide that the standard of conduct for all B/Ds and advisers will be in the best interests of the investor. This same provision also states that "such rules shall be no less stringent than the standard applicable to investment advisers under the

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Advisers Act" and, similar to provisions in the Exchange Act, that compensation based on commissions shall not itself be considered a violation of the fiduciary standard.

As previously noted, Dodd-Frank also mandated that before the SEC could implement any of these rules it had to report on the current regulatory standards for investment advisers and brokers. The SEC issued such a report in January 2011, and in March 2013 it issued a request for data and other information regarding a potential uniform fiduciary standard of conduct and the potential harmonization of investment adviser and broker-dealer regulation. The comment period for that SEC request closed on July 5, 2013, and the Chair of the SEC, Mary Jo White, publicly announced in March 2015 that the SEC will make addressing these issues a priority.

President Obama and the Department of Labor

The rules governing qualified retirement plans, known as ERISA and overseen by DOL, are independent of rules applicable to B/Ds and RIAs. The ERISA rules apply to parties who provide very specific services regarding certain retirement plan assets and they include stringent provisions against self-dealing. While narrow in their current scope, these rules impose an extensive fiduciary duty on parties providing certain services to ERISA plan assets, regardless of whether the parties are RIAs or B/Ds.

In 2010, DOL issued rules expanding the application of the fiduciary definition under ERISA, but then withdrew them a year later after B/Ds asked for more economic analysis. In February 2015, President Obama called on DOL to move forward with its proposed fiduciary rulemaking expansion. DOL drafted a proposed rule, which was submitted to the Office of Management and Budget for review, and on April 14, 2015, it was released for a 75-day notice and public comment period, which recently was extended for an additional 15 days. The proposed rules expand the types of retirement investment advice covered by fiduciary protections. Specifically, subject to certain exemptions, any individual receiving compensation for providing advice that is individualized or specifically directed for a retirement plan participant or IRA owner for consideration in making a retirement investment decision is a fiduciary.

The Next Chapter

Regardless of the changes to address investor confusion that are implemented by the SEC and DOL, we believe that to be a workable solution it is crucial that the final SEC and DOL rules regarding investment services be designed to serve the best interests of all types of investors. We also believe it is important that the final DOL rules don't impose on RIAs - who already are required to serve their clients as a fiduciary – reporting or other requirement which are inconsistent with those imposed by the SEC.

Changes being proposed to protect investors will be resisted by many firms who purport to serve their customers' best interest, but are unwilling to be held to a fiduciary standard. We appreciate that these changes may be costly to some of these firms, but for the sake of all investors we hope this next chapter gets written sooner than later.

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About Gresham

Gresham Partners is a nationally recognized* independent investment and wealth management firm that serves its clients as a multi-family office and an outsourced chief investment officer. Gresham has been serving select families, family offices, foundations and endowments since the firm was established in 1997. Today, we manage or advise on over $6.5 billion for about 100 clients located nationally.

We are committed to providing superior investment performance by utilizing select, difficult-to-access managers that are located globally in a full range of asset classes and are not affiliated with Gresham. We make these managers available to our clients in a flexible format well suited to achieving a broad spectrum of investor goals. As a multi-family office, we integrate this investment approach with comprehensive wealth planning and management services to address the full range of each client's financial needs, often avoiding the need for them to maintain a family office.

Gresham is wholly owned by its senior professionals, client fees are its sole source of compensation, it avoids conflicts of interest that affect many other firms, and it serves its clients as a fiduciary, dedicated to serving their best interests.

*Notes for "nationally recognized" Statement

Gresham has been recognized by *Barron's* (2013-2017), *Family Wealth Report* (2017) and *Financial Advisors RIA* (2016-2017) based on data provided by Gresham in surveys conducted by the group or publication. 2017 rankings are 9 of 100, 1 of 12, and 39 of 214, respectively. These recognitions are believed to be generally relevant to existing clients, potential clients and consultants in the selection and retention of a firm like Gresham. These recognitions are only one of many factors that may be relevant in determining whether to retain an investment advisor.

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