



March 23, 2009

The Honorable Christopher J. Dodd  
Chairman  
The Honorable Richard C. Shelby  
Ranking Member  
Senate Committee on Banking, Housing, and Urban Affairs

Dear Chairman Dodd and Ranking Member Shelby:

The North American Securities Administrators Association (NASAA), the Consumer Federation of America (CFA), and the Investment Adviser Association (IAA) are writing in response to testimony, regarding the legal standards of care owed to investors by broker-dealers and investment advisers, before the Senate Banking Committee at its March 10 hearing entitled “Enhancing Investor Protection and the Regulation of Securities Markets.”

First, we applaud Chairman Dodd’s pledge in his opening statement to rebuild the nation’s financial architecture with a “tough new set of protections for regular investors” that will “ensure a new era of responsibility” in financial services. Nothing is more critically important as Congress moves forward in its effort to reform the regulation of the financial services industry. Further, we agree with statements by Senator Shelby that the highest priority should be for Congress to attack the source of our economic problems in order to stabilize our financial system and get credit flowing again.

Our shared focus on promoting legislative changes that will strengthen investor protection makes it imperative that we respond to testimony offered at the hearing by the Securities Industry and Financial Markets Association (SIFMA). While we agree that investor protection would be strengthened if there was a consistent legal standard of care governing business conduct of financial institutions’ provision of investment advisory services to investors, we strongly disagree with SIFMA that the standard should be anything less than fiduciary duty. As discussed below, we believe that investors receiving advisory services deserve protections provided by the fiduciary duty standard – the highest standard of care recognized under the law.

## **All Investors Receiving Investment Advice Should be Protected by the Same Standard of Care**

We believe that a functional approach to regulation would best serve the interests of investor protection. Consistent with such a functional approach to regulation, brokers and advisers should be held to the same high standards depending not on the statute under which they are registered, but upon the services they are providing to clients. If the service being offered bears the core characteristics of investment advisory services from the investor's perspective, it should be subject to the same high standards and duties.

However, at the March 10 hearing, SIFMA dismissed the legal standards applicable under existing law. It stated:

Rather than perpetuating an obsolete regulatory regime, SIFMA recommends the adoption of a "universal standard of care" that avoids the use of labels [such as fiduciary] that tend to confuse the investing public, and express, in plain English, the fundamental principles of fair dealing that individual investors can expect from all of their financial services providers.

Despite our apparent agreement with SIFMA regarding the need for a functional regulatory approach and application of a consistent standard of care, we strongly disagree that the appropriate "universal" standard of care should simply express principles of fair dealing. Instead, we submit that the fiduciary standard – which offers *the highest level of investor protection* – should apply.

## **A Fiduciary Duty is Owed by Investment Advisers under Existing Law**

All SEC-registered investment advisers are subject to an overarching fiduciary duty under the Investment Advisers Act of 1940.<sup>1</sup> This duty has been upheld by the U.S. Supreme Court<sup>2</sup> and reiterated by the Securities and Exchange Commission (SEC) in various pronouncements over the years.<sup>3</sup>

*In simplest terms, the fiduciary duty is the obligation at all times to place the client's interests first and to eliminate or mitigate any conflicts of interest. As fiduciaries, investment advisers have an affirmative duty to act in the best interests of their clients and to make full and fair disclosure to clients regarding conflicts of interest.*

We believe that the investor protection benefits of investment adviser fiduciary standards should be extended to anyone who offers investment advice. Stated differently, broker-dealers and others in the financial services industry that provide investment advice should be bound by the same fiduciary standards as investment advisers.

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<sup>1</sup> Public Law No. 76-768, 54 Stat. 847.

<sup>2</sup> *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

<sup>3</sup> *See, e.g., In re: Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948).

## **A “Fair Dealing” Standard is Far Lower than a Fiduciary Standard**

Although SIFMA did not elaborate on its proposed “fair dealing” standard, it would appear to be based upon the duty of good faith and fair dealing applicable to the arm’s length relationships between commercial parties under contract law. The Uniform Commercial Code (UCC) provides that “Every contract or duty within [the UCC] imposes an obligation of good faith in its performance or enforcement.”<sup>4</sup> The UCC defines “good faith” as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”<sup>5</sup>

Despite the superficial appeal of this “plain English” standard, let there be no doubt that application of this commercial standard to the relationship of financial service providers and their clients would greatly diminish investor protection.<sup>6</sup>

The fiduciary duty is the highest standard of care recognized under the law and serves as a bedrock principle of investor protection.<sup>7</sup> It is far higher than the commercial law-based “fair dealing” standard proposed by SIFMA and should not be replaced.

## **Congress Should Extend the Same Fiduciary Duty to All Entities Providing Advisory Services to Investors**

Surely we can all agree that, in the current climate, there must be no weakening of investor protections. We therefore urge you to resist the call to water down the standards applicable to advisory activities and instead to extend application of the fiduciary duty to all those engaged in advisory services.

In this regard, we urge the Banking Committee to consider NASAA’s recent call for Congress “to apply the fiduciary duty to all financial professionals who give investment advice regarding securities – broker-dealers and investment advisers alike. This step will enhance investor protection, eliminate confusion, and even promote regulatory fairness by establishing conduct standards according to the nature of the services provided, not the licensing status of the provider. For all financial professionals, the interests of the client must come first at all times. Investors deserve no less.”<sup>8</sup>

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<sup>4</sup> UCC § 1-304.

<sup>5</sup> UCC § 1-201(b)(20). Similarly, § 205 of the Restatement (Second) of Contracts states that “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”

<sup>6</sup> “It must be remembered that the implied obligation of good faith is not the equivalent of a fiduciary duty to protect the interests of one of the contracting parties; it is to recognize and act in accordance with the reasonable expectations of both parties.” *Shriver v. Baskins-Robbins Ice Cream Co.*, 1993 U.S. Dist. LEXIS 19173 at \*8 (1993). In contrast, a fiduciary relationship is “one of trust and confidence and imposes the duty on the fiduciary to act with the utmost good faith.” *Medical Group Fin. Servs. v. United States Life Ins. Co.*, 350 F. Supp. 2d 298, 302 (D. Mass. 2003) (quoting *Hendrick v. Hendrick*, 755 A.2d 784, 789 (R.I. 2000)).

<sup>7</sup> See *Southern California Meat Cutters Unions & Food Employers Pension Trust Fund v. Investors Research Co.*, 687 F. Supp. 506, 509 (C.D. Cal. 1988).

<sup>8</sup> Fred Joseph, President, North American Securities Administrators Association, Remarks at the National Press Club (Jan. 29, 2009).

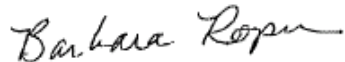
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As the Banking Committee moves forward in its regulatory reform efforts, we stand ready to offer assistance and continued support regarding the extension of fiduciary standards to all entities providing investment advice.

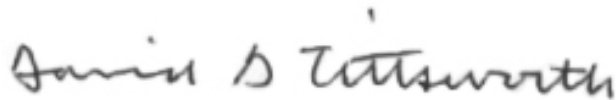
Respectfully,



Fred Joseph  
Colorado Securities Commissioner  
President  
North American Securities Administrators Association



Barbara Roper  
Director of Investor Protection  
Consumer Federation of America



David G. Tittsworth  
Executive Director  
Investment Adviser Association

Cc: Senate Banking Committee members