

Brokers Were Fiduciaries in 1930's, and Remain Fiduciaries Now

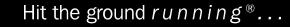
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ARE YOU A GOOD BROKER?

- Do you have a good relationship with your clients?
- Do you know their dreams, their aspirations?
- Are your clients confident in you?
- Are you, as evidenced by your certifications, designations, an expert in what you do?







How would you describe your relationship with your customers?

Do customers rely on your advice?

What to buy? What to sell? Asset allocation? Market timing?

Any aspect of financial planning, other than investments?

Hit the ground $running^{\mathbb{R}}$...





Do you INVITE a close relationship with your customers? •Do you know your customers rely on your advice? •Do you hold out as an expert? •Do you use a term describing yourself as an advisor or consultant or manager?



•Does your firm say anywhere: "We act in best interests of our customers"?

•Does your firm describe "customers" as "clients"?



TRUST ME. IM A STOCKBROKER



YOU ARE **MOST LIKELY ALREADY A** FIDUCIARY

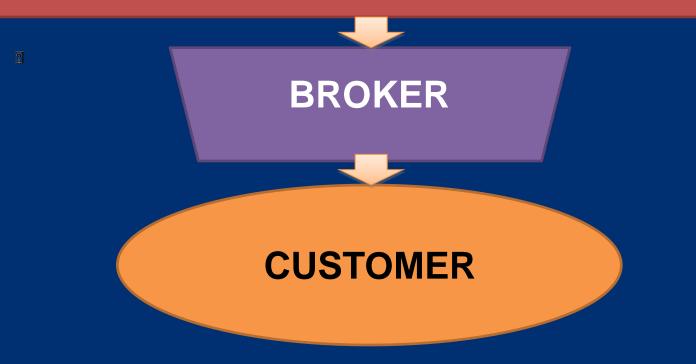
Hit the ground $running^{\otimes}$...





THE ARMS-LENGTH RELATIONSHIP

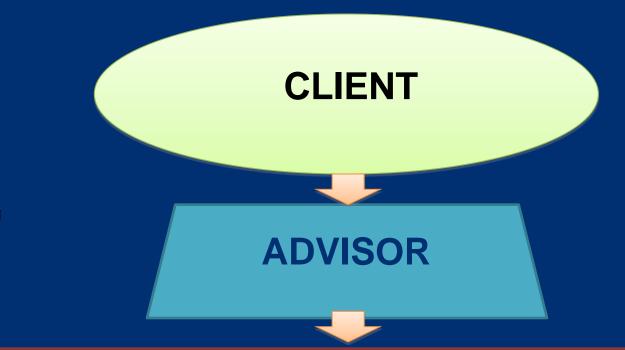
Investment Product Manufacturers Dealers in Securities







THE FIDUCIARY RELATIONSHIP



Investment Product Manufacturers Dealers in Securities





PRODUCT MANUFACTURER'S REPRESENTATIVE

PURCHASER'S REPRESENTATIVE

(SALESPERSON)

(FIDUCIARY)

Hit the ground $running^{(m)}$...





All brokers are AGENTS of their customers

They possess *limited* fiduciary duties

Best execution

•Safeguarding of customer's assets (due to custody)

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When are **BROAD** Fiduciary Duties Imposed Upon Brokers?

•Due Care

•Loyalty

Utmost Good Faith







The Many Paths to Fiduciary Status – with <u>BROAD</u> Fiduciary Duties Imposed – for Brokers

•ADVISORS ACT: Registration as RIA required ("Special Compensation" received)

•SEC: Discretion

COURTS: "Control" (de facto discretion)

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TODAY WE FOCUS ON:

State Common Law: Relationships Based
Upon Trust and Confidence Exist When:

Broker (registered representative)

Personalized investment advice provided
Reliance upon the broker by customer
Some type of acceptance (either by words or conduct) of the fact of that reliance

State

SUNY College of Technology

- Does not depend upon what written documents govern the account
- Acceptance may be <u>inferred</u> by many different actions of the broker





Why? Dodd-Frank Section 913:

The pendulum swings full circle.



Let's examine HISTORY





1905 Treatise: Tough Rule ("Sole Interests")

•Stockbroker has "no interest in the transaction" ... "except his commissions"

•<u>Rule:</u> Whatever benefits result from acting as broker flow to the CUSTOMER alone

John R. Dos Passos, A TREATISE ON THE LAW OF STOCK-BROKERS AND STOCK EXCHANGES (1905 ed.)





1934: "She had great confidence in (the stockbroker's) honesty, skill and experience in investments ... he expected and invited her to have absolute confidence in him ..."



Court held: relationship of stockbroker to customer was one of "trust and confidence" Birch v. Arnold, 88 Mass. 125; 192 N.E. 591 (1934)





1940: Widow received insurance money, trusted banker (broker) to "advise and assist" in making investments.

Several conversations between widow and banker (broker) over several years

"There existed a continuing confidential and fiduciary relationship between the parties"

Laraway v. First National Bank Of La Verne, 39 Cal. App. 2d 718; 104 P.2d 95 (1940)





SEC 1940 Annual Report:

"If the transaction is <u>in reality</u> an arm's-length transaction between the securities house and its customer, then the securities house is <u>not</u> subject to fiduciary duty.

SEC'S WARNING: "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."





WHO SAID THIS VERY ENCOMPASSING STATEMENT?

• Essentially, a broker or agent is a fiduciary and he thus standards in a position of trust and confidence with respect to his customer or principal.

• He must at all times, therefore, think and act as a fiduciary.





WHO SAID THIS VERY ENCOMPASSING STATEMENT?

• [A broker] owest his customer or principal complete obedience, complete loyalty, and the exercise of his unbiased interest.

• The law will not permit a broker or agent to put himself in a position where he can be influenced by any considerations other than those to the best interests of his customer or principal.





Who said brokers are fiduciaries?

FINRA (formerly N.A.S.D.)

The[®] *Bulletin* - National Association of Securities Dealers, Volume I, Number 2 (June 22, 1940)





1942: NASD adopts RULES OF CONDUCT for brokers and dealers





1942: Brokerage firm solicited customersBrokers analyzed securities holdings of potential customers

Brokers recommended whether to hold or sell securities

Brokers recommended what to purchase

•Held: As to the conduct of the firm of making its advice available and in soliciting customer's confidence ... the very function of furnishing investment counsel constitutes a fiduciary function.

In the Matter of William J. Stelmack Corp., Securities Exchange Act Releases 2992, 3254





INVESTMENT ADVISERS ACT OF 1940

Broad definition of "investment adviser"

BUT: Exempt from registration: brokers who provide "solely incidental" advance and receive "no special compensation"

Hit the ground $running^{\otimes}$...

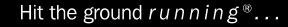




INVESTMENT ADVISERS ACT OF 1940

1940: known that "investment counsel" were fiduciaries

Nothing in the Advisers Act stated that brokers were <u>NOT</u> fiduciaries when a relationship of trust and confidence exists







1948: Typically "the customer does not come in off the street but is actively solicited by a salesman"

The broker "almost inevitably renders some advice as an incident to his selling activities"

The broker "may go further to the point where he instills in the customer such a degree of confidence in himself and reliance upon his advice that the customer clearly feels – and the salesman knows the customer feels – that the salesman is acting in the customer's interest."





-cont. 1948:

"You have nothing resembling an arm's-length principal transaction ... You have what is in effect and in law a fiduciary relationship."

Address by Louis Loss, Chief Counsel, Trading & Exchange Division, SEC, "The SEC and the Broker-Dealer" (March 16, 1948)





SEC 1963 Special Report:

"[W]here 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...."





SEC 1963 Special Report:

"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."





SEC 1963 Special Report: WARNING

Brokerage firm 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"





Hit the ground $running^{\otimes}$...





Trust-Based Selling: Answers these key customer questions:

1.Do you know what you are talking about? – competence; expertise

2. Will you recommend what is best for me? – customer orientation

3.Are you truthful? - honesty; candor

Ingram, LaForge, **Sell** (Cengage Learning, 2012),





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DUTY OF DUE CARE

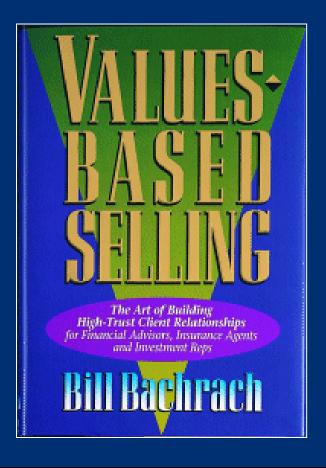
DUTY OF LOYALTY

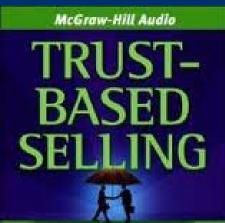
DUTY OF UTMOST GOOD FAITH





Have you been taught to engage In trust-based selling?



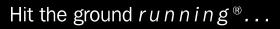




Charles H. Green



Kanada Institutta Este Plansenco





FINANCIAL

The Art of

Creating an Impiring

> Financial Strategy

EVOKE.

A Life Planning methodology for client engagement

The Real Property in which the