

# 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?**

## 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 advertise “objective advice”?
- Does your firm say *anywhere*: “We act in best interests of our customers”?
- Does your firm describe “customers” as “clients”?



**YOU ARE**  
***MOST LIKELY***  
**ALREADY A**  
**F I D U C I A R Y**

## THE ARMS-LENGTH RELATIONSHIP

Investment Product Manufacturers  
Dealers in Securities



BROKER



CUSTOMER

# THE FIDUCIARY RELATIONSHIP



**PRODUCT  
MANUFACTURER'S  
REPRESENTATIVE  
  
(SALESPERSON)**

**PURCHASER'S  
REPRESENTATIVE  
  
(FIDUCIARY)**



# All brokers are AGENTS of their customers

They possess limited fiduciary duties

- Best execution

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

## When are BROAD Fiduciary Duties Imposed Upon Brokers?

- Due Care
- Loyalty
- Utmost Good Faith



# The Many Paths to Fiduciary Status – with BROAD Fiduciary Duties Imposed – for Brokers

- **ADVISORS ACT:** Registration as RIA required (“Special Compensation” received)
- **SEC:** Discretion
- **COURTS:** “Control” (*de facto* discretion)

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

- 1) *Broker (registered representative)*
- 2) *Personalized investment advice provided*
- 3) *Reliance upon the broker by customer*
- 4) *Some type of acceptance (either by words or conduct) of the fact of that reliance*
  - Does not depend upon what written documents govern the account
  - Acceptance may be inferred by many different actions of the broker

***Why?* Dodd-Frank Section 913:**

**The pendulum  
swings full circle.**

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***Let's examine HISTORY***

## 1905 Treatise: Tough Rule (“Sole Interests”)

- Stockbroker has “no interest in the transaction” ... “except his commissions”
- Rule: 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 in reality an **arm's-length transaction** between the securities house and its customer, then the securities house is not 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 stands 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] owes 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 customers

- Brokers 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” advice and receive “no  
special compensation”

# INVESTMENT ADVISERS ACT OF 1940

1940: known that “investment  
counsel” were fiduciaries

Nothing in the Advisers Act stated  
that brokers were NOT 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”

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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**”



## 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?*

