DUAL REGISTRANTS AND THE BEST INTEREST RULE

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I. INTRODUCTION

(i.) A Little Background

In Notice to Members 03-68, then NASD[2] made known the obligation of NASD member firms to ensure that customers are being appropriately charged on a fee basis when taking into account the actual cost of the customer and other available fee configurations and preferences. NASD also cited the need for full disclosure of all financial terms.[3] This guidance is also clearly focused on wrap fee programs, a then-emerging fee configuration given the decline in transactional pricing associated with competition in the brokerage industry. These fees and disclosures are typically made in the Form ADV and sales and advertising related literature. The NASD also suggested that dual registrants should disclose scenario fees where wrap fee account configuration might cost a client more than a transaction base fee structure.

The 2005 Broker-Dealer Exemption Rule[4] was vacated by the District of Columbia Circuit Court of Appeals in 2007 in *Financial Planning Association (FPA) v. Securities and Exchange Commission.*[5] Under the newer guidelines, hourly, project-based fees and other episodic or transactional advice might also tend to require that broker dealers register,

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2. Nancy Condon and Herb Perone, *NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority*, FINRA News Release (July 30, 2007).

3. *See* NASD, NOTICE TO MEMBERS 03-68 (2003).

4. Securities and Exchange Commission, *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, 17 C.F.R. Part 275 [Release Nos. 34-51523; IA-2376; File No. S7-25-99] RIN 3235-AH78 –.

5. 482 F.3d 481(D.C. Cir. 2017).

triggering Investment Advisor Registration requirement under Section 202(a)(11)(C).[6]

In 2007, in *Financial Planning Association (FPA),* the Securities Exchange Commission implemented rules requiring SEC registration for accounts with FINRA Registered Broker/Dealers having an asset-based fee charge configuration. In the following SEC implementation of procedures requiring Broker/Dealers to register advisory accounts with the SEC, due substantially to an increase of dual registrants, the market share of dual registrants managing invested assets tripled.[7]

So, does this disclosure of investment advisory fees, mutual fund revenue sharing disclosures, 12b-1 fees, marketing fees, revenue-sharing payments, mutual funds sponsorship, monies paid for sales conferences and events, educational seminars, investment research soft dollars, NYSE and NASDAQ transaction fees, payment for money flow revenues, payment for order flow revenues, and principal transaction fees immunize RIAs from a breach of fiduciary duty? Can RIAs disclose away conflicts of interest even though they present irreconcilable conflicts and/or conflicts which are clearly not in the client's best interest, as well as being contrary to the fiduciary duty standard of care?

In a speech before the National Society of Compliance Professionals on October 22, 2013, former SEC Chair MaryJo White made reference to the emerging term of "reverse churning", a practice wherein a customer with a predominantly non-traded/buy and hold strategy is nonetheless introduced to fee base/wrap fee configuration as opposed to a transactional/commission configured account.[8]

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6. *See* 15 U.S.C. § 80b-2(a)(11)(C) (2019). In the similar vein of private placements, where there is oftentimes a battle over whether or not the offering itself must be registered with the SEC, we are now looking at a somewhat analogous analysis that has to be employed with respect to the obligation of possible/apparent dual registrants with the question being asked – is a Registered Representative also required to be registered with the SEC through either RIA or as an IAR?

7. Effective March 31, 2014 many broker dealers commenced filing far more detailed SEC disclosure documents (Form ADV, Part 2A).

8. *See* Andrew J. Boden, *People Handling Other Peoples' Money*, SEC Speech (March 6, 2014); *see also* SEC Investor Bulletin, *How Fees and Expenses Affect Your Investment Portfolio* (February 2014).

(ii.) Regulation Best Interest

Regulation Best Interest includes what has been termed "four specified component obligations" including[9]:

- Disclosure Obligation[10]
- Care Obligation[11]
- Conflict of Interest Obligation[12]
- Compliance Obligation[13]

Also notable, Regulation Best Interest only applies to a "retail customer" defined as "...a natural person, or the legal representative of such person, who:

- Receives a communication of any securities transaction or investment strategy involving securities from a broker-dealer; and
- Uses the recommendation primarily for personal, family or household purposes."[14]

The Care Obligation is quite broad and is defined as the "exercise [of] reasonable diligence, care, and skill in making the recommendation". In terms of recommendations covered, it has been extended to include recommendations of the types of securities account to open for a client (for example, IRA, qualified or other type of account), rollovers or transfers from one account to another, as well as any securities transaction or investment strategy involving securities including explicit hold recommendations, as well as implicit hold recommendations "...that are the result of agreed-upon account monitoring between the broker-dealer and the retail customer."[15]

The implementation of Regulation Best Interest is still somewhat indeterminate and it appears to have different applications on the investment

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9. Securities and Exchange Commission, *Regulation Best Interest – A Small Entity Compliance Guide* (September 23, 2019).

10. *Id.* at 4-6.

11. *Id.* at 6-8.

12. *Id.* at 9-11.

13. *Id.* at 11-12.

14. *Id.* at 3-4.

15. *Id.* at 6-8.

advisory side, as opposed to the Broker/Dealer side.[16] Some even suggest that it might result in the lowering of what is deemed to be the long-standing fiduciary standard as relates to investment advisors. The Best Interest Rule is applicable to stand-alone broker dealers, dual-registrants, and SEC registered investment advisors in the broker/dealer sector.[17]

Some may argue that Regulation Best Interest will further erode the "Solely Incidental" exception by more broadly characterizing the broker/dealer as being in the business of giving advice for compensation, thereby requiring registration as an Investment Advisor contravening that Broker Dealer Exception under Section 202(a)(11)(C) of the 1940 Act.[18] Some also argue these "solely incidental" interpretations in recent guidance will have the effect of requiring more broker/dealers to file as investment advisors with the SEC.[19] So, how much advice can broker dealers and Registered Representatives give without registering as investment advisors?[20] Numerous sectors have had occasion to comment on Regulation Best Interest and its ultimate implementation and a perusal of these various musings brings forth the issues associated with it.[21]

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16. Securities and Exchange Commission, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, 17 C.F.R. Part 276 [Release No. IA-5248; File No. S7-07-18] RIN 3235-AM36 –.

17. Securities and Exchange Commission, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 17 C.F.R. Part 240 [Release No. 34-86031; File No. S7-07-18] RIN 3235-AM35.

18. Securities and Exchange Commission, *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser*, 17 C.F.R. Part 276 [Release No. 1A-5249].

19. The SEC's interpretation regarding the solely incidental exception of the Broker-Dealer exclusion from applicability of the Investment Adviser Act definition of Investment Adviser is effective July 12, 2019.

20. Pursuant to Securities Act of 1933 Sections 3 and 4, those selling exempt securities or otherwise engaging in exempt transactions (*i.e.*, private placements, intrastate offerings – offerings which are exempt from the registration requirements of the Securities Act of 1933), but it must still register, either the state of sale, the SEC or both, depending on the nature and size of the offering.

21. *See, e.g.*, David W. Soden, *The New Standards for Investor Protection: An Analysis of Regulation Best Interest, Form CRS and Two Interpretations of the US Investment Advisers Act*, THE NATIONAL LAW REVIEW (September 7, 2019); *Implementing the SEC Regulation Best Interest Standard* (2020); *The impact of SEC's new advice standards on broker-dealers and investment advisers*, *How to prepare for the SEC best interest standard,* DELOITTE PERSPECTIVES (2019); Brian

Contemporaneous with the issuance of Regulation Best Interest, the SEC released its "Commission Interpretation Regarding Standard of Conduct for Investment Advisers" effective July 12, 2019.[22] While making reference to the term "best interest" – it does not invoke specific provisions of Regulation Best Interest. Rather, it includes a very detailed summary of the current state of the fiduciary duty owed by an investment advisor, as well as more particularized newer guidance which mirrors, in some respects, many of the elements of Regulation Best Interest.[23]

(iii.) A Recent Working Paper

A recent working paper written by Finance Professor Nicole M. Boyson, Ph.D. of Northeastern University in May of 2019 suggests that dual-registered investment advisors may tend to present the worst of both worlds. This working paper concludes that Dually-Registered Investment Advisors are plagued with glaring conflicts of interest including their involvement with the cross-selling of insurance products, the sponsorship and management of wrap fee-type accounts, revenue sharing with mutual funds, as well as their actual affiliation with mutual funds.[24]

Professor Boyson's white paper examined these categories of investing customers interfaced with RA's including retail RA clients, as well as

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Menickella, *SEC Approves Reg BI Requiring Financial Advisors To Act In Best Interests of Clients*, FORBES (June 8, 2019).

22. Securities and Exchange Commission, *Regulation Best Interest – A Small Entity Compliance Guide*, at 6-17 (September 23, 2019). (Also reiterating and giving cite to long-standing interpretations of Investment Advisers fiduciary duty under the Advisers Act. It includes a number of elements for consideration on a sliding scale based upon numerous factors – in somewhat vague and broad brash fashion. Making repeated use of the term "best interest" without invoking the term "Best Interest.")

23. *Id.* at 8-11. "[I]n our view, the duty of care requires an investment advisor to provide investment advice in the best interest of its client, based on the client's objectives." So, are we to understand that this more clearly articulated fiduciary standard is separate and apart from Regulation Best Interest, do they complement one another, or does their respective application overlap?

24. Nicole M. Boyson, *The Worst of Both Worlds? Dual-Registered Investment Advisors Northeastern University*, D'Amore-McKim School of Business. Northeastern U. D'Amore-McKim School of Business Research Paper No. 3360537 (December 1, 2019).

institutional RA clients. The article also points out statistics indicating that while dually-registered Investment Advisors are required to act as fiduciaries, given these conflicts, their overall performance is not in conformity with the conduct required of a fiduciary.[25] Professor Boyson's working paper has also opined that dual-registrant advisors are "50 percent more likely to commit misconduct than stand-alone brokers and dual-registered RIAs are statistically more likely to have a record of fraud claims against them".[26]

(iv.) RIA Statistics

The most recent statistics available, as of December 2018, reflect that there were 8,235 SEC-Registered retail Registered Investment Advisors with 318 of these being dually registered RIAs.[27] Total cumulative assets under management of retail Registered Investment Advisors as of December 2018 stood at $41.4 billion and 40,877,325 accounts.[28] Since 2005, the number of Registered Retail Broker-Dealers has declined from over 6,000 to 2,766[29] in 2018, with the number of investment advisors increasing from 9,000 to over 13,000.[30] According to Devin Ryan of JMP Securities, he has indicated that

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25. *Id.* at 1, 3, 4 (noting that "being a dual-registered RIA is a strong predictor of subsequent fraud").

26. *Id.* at 4.

27. Regulation Best Interest Release No. 34-86031; File No. S7-07-18. Securities and Exchange Commission, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 17 C.F.R. Part 240 [Release No. 34-86031; File No. S7-07-18] RIN 3235-AM35 at 413.

28. *Id.* at 414, *See also* Tobias Salinger, *Record RIAs, Bullish Outlooks Put Financial Advisors in The Spotlight*, FINANCIAL PLANNING (September 17, 2019) ("RIAs are growing twice as fast as the S&P 500 and the U.S. economy."); Charles Paikert, *No end in sight: "Torrid RIA M&A Market Set To Exceed 200 Deals in '19"*, FINANCIAL PLANNING, (July 9, 2019).

29. Securities and Exchange Commission, Regulation Best Interest: The Broker-Dealer Standard of Conduct, 17 C.F.R. Part 240 [Release No. 34-86031; File No. S7-07-18] RIN 3235-AM35 –.

30. The past several years has seen a tapering and some suggest even a dip in the increase of the numbers of RIA/IARs.

dual registrant RIA employees of broker dealers has increased 4 percent year over year to 399,013.[31]

In 2019 the number of RIAs of all types surged 24 percent to nearly 13,000, as opposed to the current number of FINRA registered firms, 3,607 having grown by 16 percent citing Investment Advisor Association/National Regulatory Services study.[32] The four largest custodians for RIAs are Charles Schwab, Fidelity Clearing and Custody Solutions, TD Ameritrade and Pershing, with these four firms having 50 percent of RIA assets.[33]

II. NON-FINRA REGISTERED RIAS/IAR'S

(i.) Fiduciary Duty vs. Regulation Best Interest?

That investment advisors owe their clients a fiduciary duty was clearly laid out in *SEC v. Capital Gains Research Bureau*,[34] wherein the court held that the Investment Advisors Act of 1940 "reflects a congressional recognition of the delicate fiduciary nature of an Investment Advisor relationship..."[35] This duty includes the obligation that Investment Advisors must at all times perform their Investment Advisory duties with "utmost good faith and full and fair disclosure of all material facts".[36] Further, as

31. Tobias Salinger, *Record RIAs, Bullish Outlooks Put Financial Advisors in The Spotlight*, FINANCIAL PLANNING (September 17, 2019).

32. John Kimelman, *Number of RIAs Hits Record*, BARRON'S Advisor News (September 16, 2019) (A record number of SEC-Registered Investment Advisors is serving more than 43,000,000 clients with $83.7 trillion in assets under management. The majority of assets under management are concentrated among a small group of large advisors - while accounting for only 1.1 percent of SEC Registered Advisors, these mere 148 firms manage 60 percent of the majority assets – over $100 billion.).

33. Technological innovations have likewise seen the capacity to convert a traditional brokerage account to an automated account taking only a "matter of minutes." Jessica Matthews, *Schwab Doubles Down on Advisor Robo Tech as 1,100 RIAs Sign On*, FINANCIAL PLANNING, September 18, 2019 (citing Schwab's RIA Robo platform, Institutional Intelligence Services, according to Charles Schwab's Vice President of Digital Advisor Solutions Lauren Wilkinson).

34. 375 U.S. 180 (1963).

35. *Id.* at 191.

36. *Id* at 194.

noted in *Transamerica Mortgage ABV. v. Lewis,*[37] this fiduciary duty under Federal Law is derived from Section 206 of the Anti-Fraud Provisions of the Investment Advisers Act.[38]

So how broad is this fiduciary obligation? In *Abraham v. Fleschner*, the court determined that the Anti-Fraud Provisions of Section 206 are not limited to the actual purchase or the sale of the security, but rather, also includes "...frauds committed by advisors who did not make purchases or sales of securities for their client."[39] The SEC is in agreement with this and per interpretation (see SEC Release Number IA-1092, 39 SEC Docket 494, October 8, 1987 "...the pertinent provisions of Section 206 do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client").[40]

Inasmuch as Regulation Best Interest has not been fully implemented, there have been no authoritative, significant refinements of its ultimate application and interpretation other than those cited herein. Does it fully apply to Non-SEC Registered Investment Advisors? In other words, those Registered Investment Advisors filing state registrations only by merit of their having less than $100,000,000 of assets under management? Do they appear to occupy a gaping hole in the enforcement scheme for this new rule? The answer appears to be yes.

(ii.) Recent NASAA Statistics

The Investment Adviser Section Annual Report of NASAA for 2019 highlighting the 2018 Section activities has noted the following statistics for SEC Notice-filed Investment Advisors:[41]

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37. 444 U.S. 11, 17 (1979).

38. Securities and Exchange Commission, *General Information on the Regulation of Investment Advisers* (modified March 31, 2017).

39. 568 F.2d 862, 877 (2d. Cir, 1977).

40. Securities and Exchange Commission, *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, SEC Release Number IA-1092, 39 SEC Docket 494 (October 8, 1987).

41. North American Securities Administrators Association, NASAA 2019 *Investment Adviser Section Annual Report* (May 2019) (SEC Notice-Filed Investment Advisers are those RIAs registered with the SEC who are required under certain state laws to file a copy of their Form ADV and certain other filings with the

- 17,543 total state-registered investment advisers
- 90,421 SEC Notice Filed investment advisers registrations
- 10,480 total SEC Notice Filed investment advisers
- 90,421 total SEC Notice Filed investment advisers registrations
- 80 percent of state-registered advisers were comprised of one to two person shops

This report also indicates that State-Registered Investment Advisors (approximately 99 percent) client bases are comprised primarily of retail investors with the remaining 1 percent being more focused on high net worth investors.

Another NASAA report, The NASAA Investment Switch Report indicates that with Section 410 of the Dodd-Frank Act raised the Asset Under Management amount from $25,000,000 to $100,000,000.[42] This saw the transfer of more than 2,100 investment advisors from the required SEC filing to state oversight. This author wonders whether the various states will be able to oversee the responsibilities associated with these new RIA/IARD's for which they will be responsible, as this influx will clearly see an increase of required annual audits, surprise audits, compliant assessments, and the like.

Yet further, a third NASAA report, the 2019 Investment Adviser Coordinated Exams Report of the North American Securities Administrators Association indicates that two thirds of United States based advisors had less than $30,000,000 in assets under management.[43] The report also noted 72 percent of reporting advisors having only one Investment Advisor Representative with another 19 percent having only two Investment Advisor Representatives.[44] These small, Independent RIA firms are required to

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appropriate state securities authorities. These notice filings are an actual registration and can include the notice filing (but not registration) of any documents that are filed with the SEC.)

42. North American Securities Administrators Association, *Investment Adviser Switch Report.*

43. *NASAA Releases 2019 Investment Adviser Coordinated Examinations Report*, RIA in a Box (September 23, 2019).

44. The top ten Registered Investment Advisory firms as ranked by total assets under management are Financial Engines Advisors, Fisher Investments, Hall Capital Partners, Chevy Chase Trust Company, Aperio Group, Kayne Anderson Rudnick Investment Management, Moneta Group, Jasper Ridge Partners, Silvercrest Asset Management and Pensionmark Financial Group, LLC all having assets under management well over $10,000,000,000 each. Contrast this with the size of SEC

oversee all associated regulatory filings, registrations, books and records and/or procedures.

Many Registered Representatives are choosing to move to the Investment Advisor Representative model, discontinuing their FINRA registrations, thereby avoiding required compliance with FINRA Rules, such as those relating to client communications under FINRA Rule 2210.[45] However, on the RIA/IAR only model such individuals are nonetheless required to maintain a compliance program pursuant to SEC Rule 206(4)-7 – however relaxed SEC oversight and audit of these compliance programs may be.[46] Communications under the SEC Rules are now arguably subject to the emerging standard of due diligence under the Anti-Fraud Provisions of the Investment Advisors Act. RIAs must also designate a Chief Compliance Officer responsible for the firm's compliance program which also requires that all SEC registered RIAs of all registrations and proper updating of form ADV Parts 1 and 2 on an annual basis.

III. DUAL-REGISTERED BROKER DEALER/REGISTERED REPRESENTATIVES AND REGISTERED INVESTMENT ADVISORS/INDIVIDUAL ADVISOR REPRESENTATIVES

(i.) Who is a Dual-Registrant?

The terminology in this whole emerging arena of dual registrants includes the following four main categories:[47]

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registered firms where RIAs with assets under management between $100,000,000 to $1,000,000,000 comprise 57 percent of SEC registered firms (7,444) as opposed to SEC registered firms with assets under $100,000,000 – 1,849. Investment Adviser Association, 2019 Evolution Revolution: A Profile of the Investment Adviser Profession).

45. FINRA, RULE 2210 (2019).

46. Securities and Exchange Commission, Final Rule: Compliance Programs of Investment Companies and Investment Advisers, 17 CFR Parts 270 and 275 [Release Nos. IA-2204; IC-26299; File No. S7-03-03] RIN 3235-AI77 (February 5, 2004).

47. Curiously, it is not prohibited under FINRA Rules to have simultaneous registrations with two separate FINRA firms for an individual Registered Representative as long as the two broker dealer firms agree on such a configuration, but this is a different type of dual-registrant altogether.

- A dual registrant acting as a Registered Representative and an Investment Advisor Representative (IAR)
- A hybrid dual registrant, one who maintains their affiliation as a Registered Representative with a broker dealer while creating his or her own Registered Investment Advisory firm
- A dual registrant broker dealer with an affiliated entity which is also a Registered Investment Advisor
- A free-standing Registered Investment Advisor which also employs dually-registered individual financial professionals

(ii.) Dual-Registrant Statistics

The aggregate total revenues generated by broker-dealers operating on a dual-registrant status, including broker dealer firms dually registered as investment advisors, as well as stand-alone registered broker dealers, was $8.69 billion in commissions in 2018 with $20.78 billion in fees (source fees as particularized in FOCUS data which includes investment advisory fee services, administrative services and account supervision fees both broker-dealers and dually-registered firms).[48]

From here the breakdown of dually-registered investment advisors and stand-alone registered broker dealers each earning about the same amount in commissions ($4.62 billion v. $4.07 billion).[49] As it relates to fees, however, dually-registered investment advisors earned far more in fees in 2018 ($17.56 billion) as to fees of stand-alone registered BD's of $3.22 billion.[50]

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48. Securities and Exchange Commission, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 17 C.F.R. Part 240 [Release No. 34-830621; File No. S7-07-18] RIN 3235-AM35 at 410.

49. *Id.*

50. *Id.*

(iii.) The Implications of the Best Interest Rule for Dual-Registrants[51]

The recent issuance by the SEC, "Regulation Best Interest – A Small Entity Compliance Guide" describes the universe of financial professionals who will ultimately be required to follow the provisions of Regulation Best Interest including the following, *in haec verba*:

> **Dually registered financial professionals:** If you are a financial professional who is dually registered (i.e., an associated person of a broker-dealer and a supervised person of an investment adviser (regardless of whether you work for a dual-registrant, affiliated firm, or unaffiliated firm)) making an account recommendation to a retail customer, whether Regulation Best Interest or the Advisers act applies will depend on the capacity in which you are acting when making the recommendation. If you are acting as broker-dealer or associated person thereof, you must comply with Regulation Best Interest and will need to take into consideration all types of accounts that you offer (i.e., both brokerage and advisory accounts) when making the recommendation of an account that is in the retail customer's best interest.[52]
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> **Individuals registered only as broker-dealers or associated persons:** If you are only registered as an associated person of a broker-dealer (regardless of whether that broker-dealer entity is a dual-registrant or affiliated with an investment adviser), Regulation Best Interest will apply to that account recommendation, but you need to take into consideration only the brokerage accounts available. You can only recommend a brokerage account that the broker-dealer offers if you have a reasonable basis to believe that the recommended brokerage account is in the best interest of the retail

51. In the context of the new definition of "retail customer" as a "...natural person, or the legal representative of such person, who...receives a communication of any securities transaction or investment strategy involving securities from a broker-dealer; and uses the recommendation primarily for personal, family or household purposes," it is submitted by this author that this same interpretation should be afforded to public investors who file arbitration claims with the American Arbitration Association, thereby requiring the application of the consumer rules as opposed to commercial rules, with the resultant far more affordable fee structure.

52. Securities and Exchange Commission, *Regulation Best Interest – A Small Entity Compliance Guide* at 2 (September 23, 2019).

customer, and the broker-dealer otherwise complies with Regulation Best Interest.[53]

Further, with respect to those dual registrants straddling separation between the BD and RIA sides of business, the SEC has likewise sought a better definition of the term "solely incidental".[54] Registered Investment Advisory firms are required to have written compliance and supervisory procedures directly associated with their business model with required particulars including their information security policies/procedures and business continuity plan.

In 2014, the SEC made known with the announcement of its National Exam Program initiatives for the year. Its concern that dual registrants not be motivated by revenue generation for the firm versus recommendations in the best interest of the client.[55] Also notable, the outside business activities reporting requirements of FINRA Rules includes FINRA Rule 3270 is something which many argue may not be strictly pursued by the SEC.

(iv.) The Emerging Standard of Care

The Regulation Best Interest Release states that Reg BI is not applicable to investment advice given to a retail customer by a dual registrant acting in the capacity of an investment advisor. Ok, so, how do we know when a dual registrant is acting as an investment advisor? Well, the Regulation Best Interest Release goes on to indicate that a "facts and circumstances" test will be utilized to decide which hat a dual registrant is wearing when a recommendation is made, with the indicated factors given by SEC staff to include:

i. the type of account
ii. how the account is described
iii. the type of compensation

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53. *Id.* at 2-3.

54. Securities and Exchange Commission, *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser*, 17 CFR Part 276 [Release No. 1A-5249].

55. Securities and Exchange Commission, *SEC Announces 2014 Examination Priorities* (January 9, 2014); Securities and Exchange Commission, National Exam Program, Office of Compliance Inspections and Examinations, *Examination Priorities* (January 9, 2014).

iv. the extent to which the dual registrant made clear to the customer or client the capacity in which it was acting

Earlier this year, the SEC staff prepared a "Hypothetical Relationship Summary for a Dually Registered Investment Advisor and Broker Dealer"[56]. In furtherance of this objective of sharing that customers are fully advised of the distinction between the broker dealer services associated with brokerage accounts and those services associated with investment advisory accounts.[57]

Included in the SEC's Standard of Conduct Rules, Forms and Interpretations for investment advisory firms and broker dealers is the need to establish a standard of care for brokerage firms when suggesting securities transactions or investment proposals involving securities to retail customers.[58] On the flip side, investment advisors are likewise required to articulate a fiduciary standard of care to the client.[59]

In circumstances of a conflict between the assessment of the proper standard of care applicable to a Dually-Registered Investment Advisor (i.e. FINRA Rule vs. Regulation Best Interest or both?) particularly in circumstances of high or low degree of care in the context of suitability and/or the fiduciary standard of care. While investment advisors are held to the higher fiduciary standard of care when dealing with their clients, does the new regulatory scheme require a higher fiduciary standard of care with an investment advisor when selling securities, while also applying a lower standard of care when selling fixed annuities?

The fiduciary standard of care requires that investment advisors disclose all known material facts, as well as material conflicts to their clients in order to properly place their clients' interests before their own. So, can a Dually-

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56. Securities and Exchange Commission, *Hypothetical Relationship Summary for a Dually Registered Investment Adviser and Broker-Dealer*, Appendix C.

57. This CRS relationship summary requirement, which also includes required amendments to the Form ADV, known as Form CRS, will be applicable to both Broker Dealers and Registered Investment Advisors with a compliance date requirement of June 30, 2020.

58. Securities and Exchange Commission, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals (June 5, 2019) (The broker-dealer standard of conduct applies to broker-dealers with a compliance date requirement of June 30, 2020.).

59. The SEC's interpretations relating to the fiduciary interpretation of the Standard of Conduct for investment advisors had a compliance date requirement of July 12, 2019.

Registered broker be a fiduciary for certain investments but not others? This seeming game of dodgeball is really an argument which would appear to fall flat on its face in light of these clear pronouncements on this point.[60] Regulation BI, while not a fiduciary standard of care, tends to raise suitability standards.

In the context of dual-registrant firms maintaining revenue sharing arrangements with mutual fund companies, another burning issue is the applicability of the Best Execution[61] Obligation of FINRA Rule 3270, further expounded upon in FINRA Regulatory Notice 15-46.[62] For example, what share class of mutual funds are being recommended – broker sold retail funds, direct sold retail funds, institutional funds or retirement account only funds? This is important due to the various respective annual loads and/or one-time sales commissions which funds change.[63]

(v.) New Disclosure Requirements

Finally, in an SEC Release on June 5, 2019, the Securities and Exchange Commission published a *pro forma*/model for a Relationship Summary for a Dually-Registered Investment Advisor and Broker-Dealer prepared by the SEC staff, for illustrated purposes only.[64]

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60. *See In the matter of Cadaret Grant & Co., Inc.*, Securities Exchange Act of 1934 Release No. 81274 / August 1, 2017, Investment Advisers Act of 1940 Release No. 4736 / August 1, 2017, Administrative Proceeding File No. 3-18087).

61. FINRA, RULE 5310 (2014).

62. FINRA REGULATORY NOTICE 15-46 (2015).

63. The top revenue sharing mutual fund families with dual registrants includes Oppenheimer, American Funds, Franklin Templeton, AIM/Invesco, Lord Abbett, Hartford, Fidelity, Pimpco, JP Morgan, John Hancock, Black Rock and Federated Investors. Nicole M. Boyson, *The Worst of Both Worlds? Dual-Registered Investment Advisors Northeastern University*, D'Amore-McKim School of Business. Northeastern U. D'Amore-McKim School of Business Research Paper No. 3360537 at Appendix B (December 1, 2019).

64. Securities and Exchange Commission, *SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals* (June 5, 2019).

IV. DISPUTE RESOLUTION FORUMS AND THE PIABA RIA COMMITTEE STUDY

The Public Investors Arbitration Bar Association (PIABA) Registered Investment Advisor Committee coordinated a sampling of 177 separate RIA Agreements, reviewing them for various contractual features including the existence of an arbitration clause, an arbitration forum selection clause, designation of applicable arbitration rules, choice of law provisions, waiver of rights clauses and class action waivers.[65] This sampling, by no means a full and comprehensive sampling of all RIA client agreements, determined that 58 percent of these agreements contained arbitration clauses, with 48 percent contained no arbitration clauses and 2 percent remaining silent on this issue.

As far as forum selection provisions in these 177 contracts was considered, 40 percent of them designated AAA (70), 8 percent designated FINRA (14), 6 percent included forms other than AAA or FINRA and none of the arbitral forum provisions contained a JAMS forum provision. As relates to which of the AAA arbitration rules designated commercial, consumer or "other" in the applicable arbitration rules provisions of the AAA contracts, 59 percent (27) designated the AAA commercial rules, 34 percent (24) indicating "other" arbitration rules with 27 percent (19) of the RIA contracts containing AAA form selection provisions remaining silent on the applicable arbitration rules (i.e. commercial, consumer and/or other). (PIABA RIA Committee Report).

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65. The Registered Investment Advisor Committee of PIABA for 2019 included Adam Gana Co-Chair, Timothy J. O'Connor, Co-Chair, Stefan Apotheker, Celiza P. Braganca, Benjamin P. Edwards, Charles H. Field, Stuart E. Finer, Joseph S. Fogel, Christopher Lufrano, David Miller, Darlene Pasieczny, Kirk Reasonover, Jeffrey R. Sonn, Jane L. Stafford, Andrew J. Stoltmann, Teresa J. Verges, Philip L. Vujanov, Adam Weinstein, Joseph Wojciechowksi, Samuel B. Edward, *Ex Officio*, Christine Lazaro *Ex Officio*, Beverly Mitchell *Ex Officio*, Robin S. Ringo *Ex Officio,* Tiffany Zachary *Ex Officio*. Additionally, the kind efforts of the students of the University of Miami Law School including Christopher Lufrano, Philip Vujonov, Tiffany Colt and Lucas Hsu, all collectively devoted hundreds of hours of time in assessing the RIA contracts of the sampling.

V. CONCLUSION

The trend of solely FINRA registered broker dealers and FINRA associated persons switching to a dual-registrant format has been continuing at vigorous pace over the past 15 years. Some practitioners and experts opine that this new trend tending to require dual registration has afforded an opportunity for reverse churning.

Parallel to this, many thousands of individual FINRA Registered Representatives have been jettisoning their FINRA registration all together, moving to a Registered Investment Advisor/Individual Advisor Representative format, with many thousands of individuals simply setting up as sole proprietor RIA firms. Many suggest that this latter model will continue to present financial viability concerns, particularly in the case of many of these firms which do not carry errors and omissions insurance.

As of this writing, it is not fully known how non-FINRA Registered RIAs/IARs might seek to modify the arbitration and dispute resolution clauses in their contracts. Will they prefer to be in court or might they seek to have investors resolve their disputes or pursuant to forum rules that might tend to dissuade small investors from pursuing claims due to the associated costs associated with venues such as JAMS or the costs associated with the AAA commercial rules?

In a final analysis, this author suggests that Regulation Best Interest will ultimately afford protections to retail investors doing business with dual registrants by more clearly defining the responsibilities of both Broker Dealer/Registered Representatives on the one side and Registered Investment Advisor/Investment Advisor Representatives.