CHANGES TO THE REGULATION OF BROKER-DEALERS AND INVESTMENT ADVISERS UNDER TITLE IX OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

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THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, SIGNED INTO LAW BY PRESIDENT OBAMA ON JULY 21, 2010, WILL DRAMATICALLY RESHAPE THE U.S. FINANCIAL REGULATORY SYSTEM, WHILE ALSO SIGNIFICANTLY IMPACTING NON-FINANCIAL INSTITUTIONS, WHICH WILL BE AFFECTED, AT LEAST INDIRECTLY, THROUGH THEIR USE OF REGULATED FINANCIAL PRODUCTS. THIS ARTICLE FOCUSES ON TITLE IX OF THE DODD-FRANK ACT.

The first part of this article focuses on Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") as it relates to the regulation by the Securities and Exchange Commission (SEC) of broker-dealers and, to a lesser extent, investment advisers. The second part covers a number of miscellaneous provisions included within Title IX that may affect broker-dealers. The final section describes studies to be conducted by the SEC, the reorganization of the SEC, and a provision that affects current beneficial ownership and short swing profit reporting requirements.

REGULATION OF BROKER-DEALERS AND INVESTMENT ADVISERS

Overview

In light of the perceived convergence of the activities of broker-dealers and investment advisers, one of the goals of the provisions of Title IX is to implement coherent regulation of broker-dealers and investment advisers and otherwise harmonize the separate regulatory schemes. Most notably, as discussed in "Imposition of a Fiduciary Duty on Broker-Dealers" below, Title IX authorizes the SEC to impose a fiduciary standard of care on broker-dealers. Indeed, Title IX grants this authority in three separate provisions. These provisions are not uniform, however, and while the most broker-dealer specific of the provisions appears designed to tailor the effect that the fiduciary duty may have on broker-dealers, the other two provisions are not similarly limited and, therefore, raise a question as to whether the SEC can, in effect, override the limitations in one provision by acting under the other two provisions. In its attempt to harmonize the regulation of broker-dealers and advisers, Title IX also includes provisions (discussed in further detail below):

- requiring the SEC to mandate increased disclosure of the terms of the relationship between broker-dealers and investment advisers, on the one hand, and their customers and clients, on the other;
- authorizing the SEC to require broker-dealers to provide their retail customers with disclosure documents on costs, risks, and compensation;
- authorizing the SEC to issue rules applicable to broker-dealers and investment advisers with respect to sales practices, conflicts of interest, and compensation schemes;
- restricting the ability of broker-dealers and investment advisers to require that disputes with their customers and clients be resolved through arbitration; and
- mandating application by the SEC of common enforcement standards against broker-dealers and investment advisers.

Title IX also includes a number of additional provisions, discussed in "Miscellaneous Provisions Affecting Broker-Dealers", that will change the regulatory scheme applicable to broker-dealers. These provisions include:

- various matters relating to insolvency proceedings of broker-dealers;
- authorization for the SEC to issue new regulations related to securities lending and short sales;
- limitations on the ability of broker-dealers to cast proxy votes as to any "significant matter" on behalf of their customers; and
- the expansion of the SEC's enforcement powers.

Additionally, Title VII changes the definition of "security" to include security-based swaps, subjecting broker-dealers to additional regulation with regard to their security-based swap transactions.

Finally, the final section of this article describes (i) changes to the reporting requirements with regard to beneficial ownership of securities and short swing profits, (ii) a number of studies of issues related to broker-dealer regulation that the SEC must conduct, and (iii) provisions affecting the organization of the SEC.

Imposition of a Fiduciary Duty on Broker-Dealers

Background. Traditionally, investment advisers have been subject to a fiduciary duty to their clients.[1] This means that advisers must deal with their clients in utmost good faith and must disclose to their clients all material facts concerning the advisory relationship, including any conflicts of interest.[2] By contrast, broker-dealers, at least when providing "recommendations" to non-discretionary accounts, are held to a "suitability" standard. That is, they do not have to act in their customer's best interest but, instead, must only show that the recommendation is "suitable" for the customer.

Moreover, the ways in which these requirements are enforced and disputes with customers and clients resolved have evolved along different paths. Broker-dealers are closely overseen and disciplined by the SEC and the Financial Industry Regulatory Authority (FINRA) or another self-regulatory organization (SRO). In addition, because SRO rules provide broker-dealer customers with the right to resolve disputes against broker-dealers in industry sponsored arbitration forums, customers can generally resolve suitability claims against a broker-dealer in an SRO-sponsored arbitration forum.

By contrast, investment advisers are not regulated by an SRO and their clients do not have access to an SRO or industry-sponsored arbitration forum. Instead, investment adviser clients generally are forced to litigate disputes with their advisers.[3]

Meanwhile, some have argued that the roles of broker-dealers and investment advisers have converged as trade execution has become commoditized and broker-dealers have increasingly distinguished themselves (and marketed themselves) as providers of investment advice. An influential report commissioned by the SEC and conducted by the RAND Institute for Civil Justice (the "RAND Report") reveals that many investors may not understand the differences between broker-dealers and investment advisers, or the different standard of care each must provide.[4] That said, the RAND Report does not provide much support for regulatory change as to the application of "fiduciary" standards. See p. 99 of the RAND Report, which indicates high levels of investor satisfaction with individuals and firms (both broker-dealers and investment advisers) providing financial services. In any case, a vigorous debate has erupted over whether the two distinct legal standards and enforcement mechanisms remain appropriate.[5]

SEC to Study the Issue. Because broker-dealers are currently regulated by an SRO and investment advisers are not, broker-dealers are subject to a greater level of oversight and examination than investment advisers. Without expressing a view as to the appropriateness of this different treatment, the Act provides for the SEC to study the level of examination of investment advisers and the desirability of designating an SRO to oversee them.[6]

As discussed below, the Act also gives the SEC authority to make rules imposing a fiduciary duty on broker-dealers. To guide the exercise of this authority, the Act directs the SEC to conduct a study to evaluate (i) the effectiveness of existing standards of care for broker-dealers and investment advisers; and (ii) the existence of regulatory gaps in the protection of retail customers relating to the standards of care for broker-dealers and investment advisers.[7]

In conducting the study, Section 913 orders the SEC to consider several factors, including:

- whether retail customers understand the different standards of care owed by broker-dealers and investment advisers;
- the resources devoted to enforcing existing standards of care;
- existing differences in regulation between broker-dealers and investment advisers as to providing investment advice to retail customers;
- the impact of subjecting broker-dealers to the same standard of care applied to investment advisers;
- the impact of eliminating the exclusion of broker-dealers from the definition of "investment adviser" under Section 202(a)(11)(C) of the Advisers Act;[8]
- the services provided by broker-dealers and investment advisers, respectively; and
- the potential costs to retail customers, broker-dealers and investment advisers resulting from changes in regulations.

By January 21, 2011 (six months from the enactment of the Act), the SEC must deliver a report of the results of its study to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.[9]

Rulemaking Authority Granted to the SEC. The Act includes three separate provisions that give the SEC rulemaking authority to impose a fiduciary duty on broker-dealers. One of these provisions amends the Exchange Act, one amends the Investment Advisers Act of 1940 (the "Advisers Act"), and the third is contained in the Act itself. As previously noted and further described below, while the provision added to the Exchange Act appears designed to tailor the effect that the fiduciary duty obligation may have on broker-dealers, the other provisions are not similarly limited and, therefore, raise a question as to whether the SEC can, in effect, avoid the Exchange Act limitations in one provision by acting under the other two provisions.

One of the three provisions is contained in Section 913(b)-(f) of the Act and authorizes the SEC, after conducting the study described above in "SEC to Study the Issue," to issue rules to "address" the standard of care applicable to broker-dealers and investment advisers when giving personalized investment advice to retail customers[10] (or to other customers specified by the SEC).[11]

Second, new Section 211(g) of the Advisers Act authorizes the SEC to promulgate rules that would require broker-dealers (even when not acting as "investment advisers") and investment advisers providing personalized investment advice to retail customers (and such other customers as the SEC may require)[12] to act in the best interest of the client or customer and to disclose any material conflicts of interest and obtain the consent thereto of their customers or clients.

Finally, new Section 15(k) of the Exchange Act authorizes the SEC to issue a rule providing that the standard of care applicable to a broker-dealer giving advice to a retail customer is the same as that applicable to an investment adviser under Section 211(g) of the Advisers Act.[13] Accordingly, if the SEC issues rules promulgating a standard of care under Section 211(g) of the Advisers Act, then it could also issue a rule under Section 15(k) of the Exchange Act imposing that standard on broker-dealers. Since the SEC could impose that same standard on broker-dealers directly under section 211(g), however, it is not clear what, if anything, is gained by the dual structure of Sections 211(g) and 15(k), or whether this structure is purposeful.

Limitations on Rulemaking Authority. The different provisions authorizing the SEC to impose a fiduciary standard on broker-dealers also specify varying limitations on that authority. Given these differences, it is unclear whether the SEC can avoid the limitations of the most specific provision by acting under the others or whether the three provisions are meant to be read collectively such that the various limitations would apply regardless of the provision utilized by the SEC.

The SEC's broadest authority arises under Sections 913(b)-(f) of the Act, which, as noted above, is not expressly incorporated into either the Advisers Act or the Exchange Act. Section 913(f) authorizes the SEC to issue rules to "address" the standard of care applicable to broker-dealers and investment advisers when giving personalized investment advice to retail customers (or to other customers specified by the SEC). Given the lack of guidance in this provision (the SEC must "consider" the results of its study of the issue) and the ability of the SEC to cover any "specified" customers, the SEC's authority under this provision appears to be largely unconstrained.

New Section 211(g) of the Advisers Act authorizes the SEC to issue rules imposing a fiduciary standard on broker-dealers, but it limits that authority in two respects. First, to the extent the SEC promulgates a rule under Section 211(g), the rule must impose a standard of care on broker-dealers that is at least as strict as the standard applicable to investment advisers under Sections 206(1) and (2) of the Advisers Act.[14] Second, any such rule must require that broker-dealers operate in the best interest of their customers and disclose any material conflicts and obtain consent thereto from the customer.

Additionally, new Section 211(g) provides that "[t]he receipt of compensation based on commission or fees shall not, in and of itself, be considered a violation" of any standard of care applied by the SEC under Section 211(g). (Firms should, however, be aware that the level of compensation, as opposed to its mere receipt, could raise an issue.)

New Section 15(k) of the Exchange Act, on the other hand, does not appear to allow the SEC to adopt a rule other than one that incorporates the standard of care provided by any rule issued under Section 211(g) of the Advisers Act. Put simply, it would appear that the SEC cannot issue a rule under Section 15(k) unless it first issues a rule with respect to investment advisers' standard of care under Section 211(g). Moreover, any rule adopted under Section 15(k) cannot subject the broker-dealer to a continuing duty of care after giving advice or prohibit the sale by a broker-dealer of only proprietary products or of a limited range of products.

It is uncertain whether the SEC could avoid the limits of Section 15(k) by adopting rules only under Section 211(g) of the Advisers Act or Section 213(f) of the Act. While a literal reading of the Act would seem to allow this, courts might potentially view this approach as a violation of Congressional intent.

Implications. Broker-dealers have long been subject to a fiduciary duty when acting as investment advisers. They have not, however, been subject to this duty when, as to non-discretionary accounts, they fall within an exclusion from the term "investment adviser," and thus from the applicability of the Advisers Act.[15] If the SEC exercises its rule-making authority, however, a broker-dealer will have fiduciary duties as to retail customers whether or not it fits within the definition of "investment adviser" under the Advisers Act.

As described above, the Act seems to allow the SEC considerable room to tailor the standard of care applicable to broker-dealers. For instance, while the standard of care that may be imposed by the SEC under the Advisers Act must be at least as strict as Sections 206(1) and (2) of the Advisers Act, it need not be as strict as Section 206(3), which generally requires pre-trade disclosure to and consent by a client to each principal transaction (in which the firm buys securities from or sells securities to a client for its own account).

Disclosures, Sales Practices, Conflicts of Interest, and Compensation Schemes

New Section 211(h) of the Advisers Act and new Section 15(l) of the Exchange Act require the SEC to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with [broker-dealers] and investment advisers, including any material conflicts of interest."[16] These provisions also require the SEC to examine sales practices, conflicts of interest, and compensation schemes for broker-dealers and investment advisers, and authorize the SEC to issue rules restricting or prohibiting these activities. Additionally, new Section 15(n) of the Exchange Act authorizes the SEC to issue rules designating disclosure documents or information to be provided by broker-dealers to retail investors before the sale of any investment product or service.[17]

The documents must contain information about investment objectives, strategies, costs, and risks, as well as any compensation received in connection with the sale. The term "retail investor" is undefined in the Exchange Act, although the term "retail customer" is newly defined in Section 211(g)(2) of the Advisers Act.[18]

Mandatory Arbitration

New Section 15(o) of the Exchange Act[19] and new Section 205(f) of the Advisers Act[20] authorize the SEC to issue rules limiting or prohibiting the use of contractual clauses requiring customers and clients to submit any dispute arising under securities laws to mandatory arbitration. These sections apply to broker-dealers and investment advisers, respectively. The provisions are not restricted to retail customers, but rather apply to all customers and clients.

The provision applicable to broker-dealers raises the possibility of an asymmetry, since customers of broker-dealers can generally compel mandatory arbitration of disputes under SRO rules. If customers are not contractually compelled to submit disputes to arbitration, but retain the right to compel broker-dealers into arbitration, customers would be able to choose whichever forum (arbitration or the courts) they think is more favorable, while broker-dealers would be forced to defend themselves in the customer's chosen forum.

Harmonization of Enforcement Authority

New Section 15(m) of the Exchange Act[21] and new Section 211(i) of the Advisers Act[22] allow the SEC to exercise the enforcement authority provided by either the Exchange Act or the Advisers Act with regard to (i) violations of the Exchange Act related to the standard of care of broker-dealers giving personalized investment advice to retail customers, and (ii) violations of the Advisers Act related to the standard of care of investment advisers. These sections also require the SEC to seek to prosecute and sanction violations of the standards of care applicable to broker-dealers and investment advisers "to the same extent" under the Exchange Act and the Advisers Act.

The SEC's enforcement authority under the Exchange Act with regard to broker-dealers is already broadly similar to its authority under the Advisers Act with regard to investment advisers.[23] Additionally, most of the changes to the SEC's enforcement authority in the Act apply equally to the Exchange Act and the Advisers Act. These changes are described in "Treatment of Swaps as Securities" below.

The requirement that the SEC exercise its enforcement powers "to the same extent" against broker-dealers and investment advisers with regard to their respective standards of care may be a response to the perception that broker-dealers are currently more closely regulated than investment advisers. Since broker-dealers are also subject to SRO regulation, examination, and enforcement actions, the same perception may have been the impetus for the requirement that the SEC study the creation of an SRO to oversee investment advisers, as described in "SEC to Study the Issue" above.

MISCELLANEOUS PROVISIONS AFFECTING BROKER-DEALERS

SIPA and Bankruptcy Changes

Section 983 of the Act permits a customer holding futures contracts, or options on futures, in a portfolio margin account to claim status as a securities "customer" under the Securities Investor Protection Act of 1970 (SIPA) in the event of the insolvency of the broker-dealer holding the portfolio margin account.

The Act also amends SIPA to increase the cash advance paid by the Securities Investor Protection Corporation ("SIPC") to investors in a broker-dealer subject to a SIPA proceeding.[24] The Act provides the holder of a claim for cash an advance of up to \$250,000 (previously the limit was \$100,000), where the cash was held at the broker-dealer for the purpose of buying securities. This amount corresponds to the amount of cash in eligible deposit accounts insured by the Federal Deposit Insurance Corporation. SIPC, in its discretion, may increase the amount of financial protection covering claims for cash to keep pace with inflation. Note, however, that the total amount of a SIPC advance remains capped at \$500,000.

Additionally, the cap on the minimum assessment imposed on SIPC members is changed from \$150 per year to 0.02 percent of gross revenues from the securities business of each member.[25] This change does not alter the current assessment rate, which is 0.25 percent of gross revenues (currently SIPC imposes no minimum assessment).[26]

In the past, SIPC has imposed the minimum assessment when its financial resources have been ample, and it has imposed higher assessments when needed. In the event that SIPC chooses to impose a minimum assessment in the future, then it will be able to set the minimum assessment as high as 0.02 percent of gross revenues from each SIPC member's securities business. Title VII of the Act amends the Exchange Act to provide that a security-based swap will be treated as a "security" for the purposes of liquidation under the Bankruptcy Code of stockbrokers that are not SIPC members.[27] This implies that a security-based swap dealer would be a "stockbroker" under the Bankruptcy Code, and that a security-based swap counterparty would be a "customer" entitled to the special protections provided for customers under the Bankruptcy Code. These protections would not be available for claims based on uncleared security-based swaps.

Securities Lending and Short Sales

Section 984 of the Act amends Section 10 of the Exchange Act to give the SEC broad authority to adopt regulations governing securities lending transactions, which authority may have been granted so that the SEC would have the power to limit securities lending at times when it wishes to discourage short selling. In addition, the SEC is required to adopt rules increasing the transparency of available information on securities lending, which information would presumably include volume and pricing data.

Also relating to short sales, Section 929X of the Act amends Section 15 of the Exchange Act to provide that all persons are prohibited from effecting a "manipulative" short sale.[28]

Additionally, institutional investment managers subject to Section 13(f) of the Exchange Act, generally investors who either own or control over $100 million in equity securities subject to Section 13(d) of the Exchange Act, will have to submit a report of the "aggregate amount of the number of short sales" of securities each month.[29] This requirement is somewhat similar to SEC Temporary Rule 10a-3T, which the SEC adopted on October 15, 2008 and allowed to expire on July 31, 2009. Temporary Rule 10a-3T required investment managers to report short positions to the SEC on Form SH on a weekly basis.[30] The Act provides, however, that the reports will be available to the public, unlike the information previously reported on Form SH.

It is not clear whether the required reports would be of all short sales during the month, which seems to be suggested by the language of the Act, or all open positions on the last day of the reporting period, which would be consistent with the current requirements of Section 13(f) as to long positions.

Finally, the Act adds new Section 15(e) to the Exchange Act (redesignating current Section 15(e) and the following subsections). New Section 15(e) provides that broker-dealers are required to notify their customers that each customer has the right to prohibit the broker-dealer from using the customer's fully paid securities in connection with short sales. In light of the fact that it was impermissible under existing law for a broker-dealer to use fully paid securities in connection with short sales, absent a securities lending agreement, the purpose of the requirement is not clear; it seems possible that the new disclosure may confuse customers, who might infer that broker-dealers **can** use their fully paid securities absent an agreement to the contrary.

New Section 15(e) of the Exchange Act also provides that a broker-dealer must provide notice to its customers that the broker-dealer may receive compensation through lending the customers' securities.[31] Under pre-existing law, it would already be impermissible to rehypothecate customers' securities without providing notice of the practice. What is new is the requirement to notify customers specifically that the broker-dealer may profit by lending customers' securities.

Voting by Brokers

The Act amends Section 6(b) of the Exchange Act to require national securities exchanges to prohibit their member broker-dealers from casting votes on a "significant matter" on behalf of their customers absent instructions from the beneficial owner of a security.[32] In particular, unless the beneficial owner has agreed otherwise, broker-dealers will not be able to grant proxies for votes related to executive compensation or the election of directors. Additionally, the SEC is authorized to designate any other significant matters for which such proxy voting will also be proscribed.

Enforcement Changes

As discussed further below, the Act includes numerous provisions meant to strengthen the SEC's enforcement of securities regulations, including the expansion of aiding and abetting liability and enhanced whistleblower awards and protections. This article highlights several of the changes, but does not address all of the provisions of the Act related to enforcement of securities law.

New Section 209(f) of the Advisers Act gives the SEC the ability to seek monetary damages in a civil action against a person who aids or abets a violation of the Advisers Act.[33] Previously, the Advisers Act (but not the Exchange Act) limited the SEC to injunctive relief in civil actions against aiders and abettors.

Significantly, new Section 209(f) also makes it clear that an aiding and abetting charge can be based not only upon a showing that the aider and abettor "knowingly" provided assistance to the wrongful scheme, but also upon a showing that the aider and abettor "recklessly" provided such assistance. Similarly, the Act also amends the Exchange Act to incorporate the new "reckless" standard with respect to aiding and abetting charges under the Exchange Act.[34] While the aiding and abetting provision of the Exchange Act continues to require the SEC to prove "substantial" assistance,[35] new Section 209(f) of the Advisers Act does not contain that requirement. Arguably, aiding and abetting liability may arise under the Advisers Act even when the assistance provided to the violator is not "substantial."[36]

The Act also provides for the Comptroller General to conduct a study to determine the impact of authorizing a private right of action against aiders and abettors of violations of securities laws.[37]

The Act increases the compensation to be paid to whistleblowers in judicial or administrative actions that result in monetary sanctions.[38] Under new Section 21F of the Exchange Act, whistleblowers may receive an award equal to a fraction of the monetary sanctions imposed in an action based on original information provided by the whistleblower. The amount of the award is to be determined in each case by the SEC, but must fall within 10-30% of the amount of the monetary sanctions. Previously, whistleblowers could receive no more than 10% of any recovery.[39] New Section 21F(h) of the Exchange Act protects whistleblowers from retaliation by their employers.

Prior to the adoption of the Act, the Exchange Act authorized the SEC to bar an individual from associating with any broker-dealer for up to twelve months if that individual had committed a violation related to broker-dealer activities. The Exchange Act and the Advisers Act contained similar provisions with respect to municipal securities dealers, transfer agents, and investment advisers. Before the enactment of the Act, though, an individual barred from associating with broker-dealers could still associate with, for instance, an investment adviser.[40] The Act amends these provisions to authorize the SEC (or, in the case of transfer agents, the appropriate regulatory agency) to bar such individuals from associating with **any** of these entities, or with municipal advisors or credit rating agencies, for up to twelve months.[41]

Treatment of Swaps as Securities

Title VII of the Act expands the scope of the term "security" in Section 3(a)(10) of the Exchange Act to include "security-based swaps." We note that many firms that do not act as principals in swap transactions may act as agents arranging them. Accordingly, as Title VII goes into effect, firms engaging in swaps as "brokers" will be subject to securities regulations as to such transactions (*e.g.*, sending of confirmations, record-keeping, rules as to marketing and communications, supervisory obligations, and the like).

BENEFICIAL OWNERSHIP AND SHORT SWING PROFIT REPORTING, SEC STUDIES, AND SEC REORGANIZATION

Beneficial Ownership and Short Swing Profit Reporting

The Act makes a number of changes to the reporting requirements for holders of securities subject to Section 13(d) or insiders subject to Section 16(a), most significantly authorizing the SEC to shorten the time period between a transaction and the required report.[42] Additionally, Section 13(d) is amended so that the reports must only be provided to the SEC, and not to the issuer of the securities or the exchange on which they are traded.

Studies

The Act also requires the SEC to conduct a number of additionally studies to assess:

- financial literacy among retail investors;
- ways of improving investor access to information about broker-dealers and investment advisers, including any disciplinary actions;
- the extent to which private rights of action under the Exchange Act should be extended to cover securities transactions and conduct occurring outside the United States;
- the operations, structure, funding, and need for comprehensive reform of the SEC (this study is to be performed by an independent consultant); and
- the "revolving door" between the SEC and financial institutions it regulates.

Although these are merely studies and not immediate changes in the law, the conclusions reported by the SEC may affect its rulemaking and may motivate additional legislation by Congress.

Reorganization of the SEC

Additionally, the Act reorganizes the SEC in a variety of ways. Sections 961-68 of the Act require an annual report on SEC internal controls, an annual audit of the SEC's financial reporting, and a triennial report to Congress by the Comptroller General assessing the SEC's personnel management. Notably, the Act amends the Exchange Act to provide for each of the SEC's Division of Trading and Markets and its Division of Investment Management to have its own staff of examiners. Currently, the SEC's examination staff is consolidated in the Office of Compliance Inspections and Examinations (OCIE). While this provision does not mandate OCIE's dissolution, its implementation can be expected to cause the SEC to reevaluate OCIE's continued role within the SEC and how best to coordinate examinations among at least two and possibly three separate examination teams, as well as the required coordination with the Commodity Futures Trading Commission (CFTC), given the radical expansion in the number of entities registered with both the SEC and the CFTC that will result from the Act. It should also be noted that mandating separate examination staffs to broker-dealers and advisers could be at odds with the more general tendency of the Act towards increased harmonization of the regulatory schemes applicable to broker-dealers and advisers. ■

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1 *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

2 *Id.* at 194.

3 In a private lawsuit, advisers may be sued on the theory of breach of a fiduciary duty, while a litigant alleging that a broker-dealer's recommendation was not suitable would generally have to prove fraud within the meaning of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") or Rule 10b-5 thereunder. *See Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 31 (2d Cir. 1977) ("Analytically, an unsuitability claim is a subset of the ordinary § 10(b) fraud claim in which a plaintiff must allege, inter alia, (1) material misstatements or omissions, (2) indicating an intent to deceive or defraud, (3) in connection with the purchase or sale of a security.").

4 RAND Institute for Civil Justice, Perspectives on Investment Advisers and Broker-Dealers 18-19, 31-32, 89-90, 108-09, 117-18 (2008), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

5 *See, e.g.*, Dept. of the Treasury, "Blueprint for a Modernized Financial Regulatory Structure," 125-26 (Mar. 2008), *available at* http://www.treas.gov/press/releases/reports/Blueprint.pdf; Dept. of the Treasury, "A New Foundation: Rebuilding Financial Supervision and Regulation," 71-72 (2009), *available at* http://www.financialstability.gov/docs/regs/FinalReport_web.pdf; Letter from Mary L. Schapiro and Elisse B. Walter, NASD (now FINRA), to Annette Nazareth and Meyer Eisenberg, SEC (Apr. 4, 2005), *available at* http://www.sec.gov/rules/proposed/s72599/nasd040405.pdf; "SEC Oversight: Current State and Agenda," Hearing Before the Subcomm. on Capital Markets, Insurance, and Government-Sponsored Enterprises of the H. Comm. on Financial Servs., 111th Cong. 13 (July 14, 2009) (statement of Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n) (revising previous position expressed in 2005 letter), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/sec_testimony.pdf.

6 *See* Section 914 of the Act.

7 *See* Sections 913(b)-(e) of the Act.

8 Under Section 202(a)(11)(C) of the Advisers Act, the term "investment adviser" does not include "any broker or dealer whose [provision of investment advice or analysis] is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."

9 *See* Section 913(d) of the Act.

10 Section 913(a) of the Act defines a "retail customer" as: "a natural person, or the legal representative of such natural person, who—(A) receives personalized investment advice about securities from a broker, dealer, or investment adviser; and (B) uses such advice primarily for personal, family, or household purposes." The term "retail customer" is given the same definition in new Section 211(g)(2) of the Advisers Act, which is also added by Section 213 of the Act. Note that this definition does not distinguish between "widows and orphans" and highly sophisticated investors.

11 *See* Section 913(f) of the Act. This authority is not specifically included in either the Advisers Act or the Exchange Act, leaving it unclear whether this authority is independent of new Advisers Act Section 211(g) or new Exchange Act Section 15(k), both further described below.

12 *See* Section 913(g)(2) of the Act.

13 *See* Section 913(g)(1) of the Act.

14 While Sections 206(1) and (2), by their terms, relate to fraudulent activity, it was under these sections that the Supreme Court found a fiduciary duty for investment advisers. *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

15 Section 202(a)(11)(C) of the Advisers Act. The exclusion applies to any broker-dealer whose provision of investment advice or analysis is "solely incidental" to its business and that receives no "special compensation" for its advice. For further discussion of this issue, see Arthur B. Laby, "Reforming the Regulation of Broker-Dealers and Investment Advisers," 65 The Business Lawyer 395 (February 2010).

16 *See* Section 913(g) of the Act.

17 *See* Section 919 of the Act.

18 *See* the discussion of the defined term "retail customer" at note 10 above.

19 *See* Section 921(a) of the Act.

20 *See* Section 921(b) of the Act.

21 *See* Section 913(h)(1) of the Act.

22 *See* Section 913(h)(2) of the Act.

23 *Compare* Section 21 of the Exchange Act with Section 209 of the Advisers Act. *Compare also* Section 15(b)(4) of the Exchange Act and Section 203(e) of the Advisers Act.

24 *See* Section 929H of the Act.

25 *See* Section 929V of the Act.

26 *See* SIPC, "Notice to Members of Changes to Assessment Provisions Under the Securities Investor Protection Act," (July 23, 2010), *available at* http://www.sipc.org/pdf/MembershipLtr 7-23-10.pdf.

27 Most broker-dealer liquidations proceed under SIPA, but certain limited-purpose broker-dealers that are not SIPC members may be liquidated under chapter 7 of the Bankruptcy Code.

28 It is unclear what activity this covers that would not already be covered by SEC Rule 10b-5 under the Exchange Act.

29 *See* Section 929X of the Act.

30 An investment manager subject to Temporary Rule 10a-3T was required to disclose "the start of day short position, the gross number of securities sold short during the day, and the end of day short position" for every day on which the investment manager engaged in short sale trading activity.

31 *See* Section 929X of the Act. *See also* FINRA's recent enforcement action against Citigroup Global Markets, Inc., finding a failure to disclose certain material information related to securities it borrowed from its customers, including the difficulty of borrowing the securities on the open market, the commissions received during the duration of the loan, the payment of "cash-in-lieu" of dividends and the resulting tax consequences, and the fact that customers could sell the securities at any time. FINRA, "FINRA Fines Citigroup $650,000 for Direct Borrow Program Deficiencies," (April 6, 2010), *available at* http://www.finra.org/Newsroom/NewsReleases/2010/P121245.

32 *See* Section 957 of the Act.

33 *See* Section 929N of the Act.

34 *See* Section 929O of the Act.

35 *See* Section 20(e) of the Exchange Act.

36 As described in Subpart I.E. of this article, the Act amends the Exchange Act and the Advisers Act to allow the SEC to exercise its enforcement authority under either act to address violations of the standard of care for both investment advisers and broker-dealers. Therefore, in an action against a broker-dealer alleging breach of fiduciary duty (if such a duty is imposed), the SEC may be able to prove liability under the aiding and abetting standard of the Advisers Act, even if it cannot prove "substantial assistance" under the Exchange Act.

37 *See* Section 929Z of the Act.

38 *See* Sections 922-24 of the Act.

39 *See* Section 21A(e) of the Exchange Act.

40 *See Teicher v. S.E.C.*, 177 F.3d 1016 (D.C.Cir. 1999).

41 *See* Section 925 of the Act.

42 *See* Section 929R of the Act.

IN LIGHT OF THE PERCEIVED CONVERGENCE OF THE ACTIVITIES OF BROKER-DEALERS AND INVESTMENT ADVISERS, ONE OF THE GOALS OF THE PROVISIONS OF TITLE IX IS TO IMPLEMENT COHERENT REGULATION OF BROKER-DEALERS AND INVESTMENT ADVISERS AND OTHERWISE HARMONIZE THE SEPARATE REGULATORY SCHEMES.

BECAUSE BROKER-DEALERS ARE CURRENTLY REGULATED BY AN SRO AND INVESTMENT ADVISERS ARE NOT, BROKER-DEALERS ARE SUBJECT TO A GREATER LEVEL OF OVERSIGHT AND EXAMINATION THAN INVESTMENT ADVISERS.

IF THE SEC EXERCISES ITS RULE-MAKING AUTHORITY, A BROKER-DEALER WILL HAVE FIDUCIARY DUTIES AS TO RETAIL CUSTOMERS WHETHER OR NOT IT FITS WITHIN THE DEFINITION OF "INVESTMENT ADVISER" UNDER THE ADVISERS ACT.

THE ACT INCLUDES NUMEROUS PROVISIONS MEANT TO STRENGTHEN THE SEC'S ENFORCEMENT OF SECURITIES REGULATIONS, INCLUDING THE EXPANSION OF AIDING AND ABETTING LIABILITY AND ENHANCED WHISTLEBLOWER AWARDS AND PROTECTIONS.