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The Punctilio of an Honor the Most Sensitive: An Analysis of the Fiduciary Duty in the Broker/Dealer Context

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The Obama Administration recently released the “Investor Protection Act of 2009” ("IPA"), draft legislation that sets forth a new fiduciary standard for broker-dealers and investment advisers. Pursuant to the IPA, the SEC must promulgate rules to ensure that when broker-dealers and investment advisers provide advice about securities to retail investors they act "solely in the interest of the customer or client without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice."

As currently drafted, the IPA standard may surpass even the stringent obligations imposed on ERISA trustees. Certainly, the IPA standard demands much more than the current standards for investment advisers and registered representatives.

To put the proposed IPA standard in context, this document (i) provides general background on fiduciary duties (ii) compares the IPA standard to the standards applied to other financial professionals; and (iii) outlines some possible effects on BDs of the imposition of a fiduciary duty.

A. FIDUCIARY DUTY

As the attached chart shows, professionals in a range of fields must comply with a specific standard of care when providing services to clients. Often professionals must adhere to a “fiduciary” standard, and, consequently, this memo and the attached chart focus on those relationships.

When one person places confidence in the integrity and skill of another, the fiduciary duty helps protect that potentially vulnerable person. Judge Cardozo describes the scope of a fiduciary duty in the classic case of Meinhard v. Salmon:

Many forms of conduct permissible in a workaday world for those acting at arm’s length are forbidden to those bound by fiduciary ties. A trustee (i.e. fiduciary) is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior...

However, even Judge Cardozo’s classic definition provides only a general sense of the duty. In fact, the exact definition and application of a fiduciary duty varies between contexts and jurisdictions.

1 Punctilio is defined as: “1. A fine point of etiquette; 2. Precise observance of formalities.” American Heritage Dictionary.