

# One Step Forward, Two Steps Back: Arguing for a Transatlantic Investor Protection Regime

*Section 913 of the Dodd-Frank Wall Street and Consumer Protection Act authorized the Securities and Exchange Commission (SEC or Commission) to promulgate a rule creating a uniform fiduciary standard for all financial intermediaries. This rule would harmonize regulatory standards for financial intermediaries in the United States but would further distance the American system from the European Union’s (EU) Markets in Financial Instruments Directive (MiFID) regime. This Note argues against the uniform fiduciary standard. Instead, the Author argues that the United States and the EU should harmonize their regulation of financial intermediaries to create a transatlantic investor protection regime.*

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## INTRODUCTION

Congress reacted to the recent financial crisis with a wave of regulatory reforms, culminating in the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank). During the Dodd-Frank legislative process, regulators expressed concern<sup>1</sup> that the current regulatory scheme holds broker-dealers to a suitability standard while it holds investment advisers to the higher fiduciary standard.<sup>2</sup> In response to this concern, Dodd-Frank § 913 authorized the Securities and Exchange Commission to promulgate a rule that would hold all U.S. financial intermediaries to the same higher standard of care.<sup>3</sup> The Commission staff issued its Congressionally mandated report on January 21, 2011, indicating its intention to promulgate a rule imposing a “uniform fiduciary standard” that will govern all financial intermediaries.<sup>4</sup>

The uniform fiduciary standard will harmonize regulation of investment advisers and broker-dealers, yet increase disharmony with the EU’s Markets in Financial Instruments Directive (MiFID) regime, which regulates intermediaries based on a complex system of client classification rather than intermediary classification. Instead of taking one step forward and two steps back, the United States and the EU should pursue a transatlantic investor protection regime for the secondary market under which regime issuers, intermediaries and investors have a common set of obligations.

The transatlantic investor protection regime should adopt a modified version of MiFID’s system of customer classification, basing the standard of conduct upon the nature of the relationship be-

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1. See, e.g., Luis Aguilar, Comm’r, Sec. & Exch. Comm’n, A Shared Responsibility: Preserving the Fiduciary Standard (Mar. 26, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch032610laa.htm>) [hereinafter Aguilar Speech 1].

2. See discussion *infra* Part I.C.

3. [T]he Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-11].

The Dodd-Frank Wall Street Reform and Consumer Protection Act § 913(g)(1), 15 U.S.C. § 78o(k)(1) (Supp. 2010).

4. U.S. SEC. & EXCH. COMM’N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, at v (Jan. 2011), [www.sec.gov/news/studies/2011/913studyfinal.pdf](http://www.sec.gov/news/studies/2011/913studyfinal.pdf) [hereinafter 913 STUDY].

tween the intermediary and the investor. According to this standard, the harmonized regime should impose a fiduciary duty on discretionary accounts with fee-based compensation while imposing less stringent duties on non-discretionary accounts with transaction-based compensation. In addition, the transatlantic investor protection regime should place obligations on issuers to classify products for the benefit of intermediaries. Finally, the regime should place harmonized obligations on investors by imposing a modified version of MiFID's elective professional client system.

Creating a transatlantic investor protection regime would have three key advantages: first, by harmonizing cross-border regulation in the world's two largest investment markets, it would increase international financial services competition, therefore decreasing fees and increasing investor choice. Second, it would address the concerns of uniform fiduciary standard proponents by decreasing investor confusion and opportunities for regulatory arbitrage. Finally, it would address the concerns of uniform fiduciary standard opponents by preserving legitimate broker-dealer business practices and investor access.

Section I will compare the investor protection regulatory schemes of the United States and the EU. In order to give a complete picture of secondary market regulation, the Author will separately discuss the corresponding obligations of intermediaries, issuers and investors. Section II will argue against the uniform fiduciary standard. It will show that although the uniform fiduciary standard will provide some benefits, those benefits are overwhelmed by severe costs that will result from stifling legitimate broker-dealer business practices and decreasing harmony with the EU. Finally, Section III will propose a better alternative to the uniform fiduciary standard: a fully harmonized transatlantic investor protection regime. It will outline the contours of a transatlantic investor protection regime that will satisfy both proponents and opponents of the uniform fiduciary standard. In so doing, the Author will describe the obligations that will apply to all intermediaries, issuers and investors.

## I. COMPARING THE INVESTOR PROTECTION REGIMES OF THE UNITED STATES AND THE EU

Issuers create securities and distribute those products through intermediaries, who ultimately pass the securities on to investors. The policy debate about investor protection in the secondary market

has focused almost exclusively on intermediaries.<sup>5</sup> Intermediaries are the key actors in the secondary market and are best situated to prevent abuse; issuers and investors themselves, however, may also play a role in combating abuse and creating a more successful regulatory scheme. Therefore, an effective comparison of the U.S. and the EU regulatory regimes requires an analysis of the corresponding obligations of issuers, intermediaries and investors.

#### A. Overview of the U.S. Regulatory Scheme

The United States uses an overlapping system of state and federal regulation to govern the conduct of intermediaries. Investment advisers and broker-dealers face different regulatory requirements, and they must register with different agencies.

The anti-fraud provisions of the Investment Advisers Act of 1940 (the Investment Advisers Act) impose a fiduciary duty on investment advisers with respect to their clients.<sup>6</sup> Investment advisers must also comply with the anti-fraud provisions of the Securities Exchange Act of 1934 (the Exchange Act) and its corresponding rule prohibiting fraud or deceit “in connection with the purchase or sale of any security.”<sup>7</sup> Investment adviser firms and their registered representatives must register with the SEC if their net assets meet a certain threshold; if they fall below that threshold, investment advisers must instead register with the state in which they are located.<sup>8</sup>

The Investment Advisers Act exempts broker-dealers from the jurisdiction of the Act.<sup>9</sup> The Exchange Act requires broker-

5. *See, e.g., id.*

6. It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client[.]

Investment Advisers Act of 1940 §§ 206(1)–(2), 15 U.S.C. § 80b-6 (2006); *see* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) (interpreting §§ 206(1)–(2) to impose fiduciary duty on investment advisers).

7. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); 17 C.F.R. 240.10b-5 (2011).

8. Investment Advisers Act of 1940 § 203A, 15 U.S.C. 80b-3a (2006).

9. “Investment adviser . . . does not include . . . any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore[.]” *Id.* § 202(a)(11)(c), 15

dealers to register with the SEC<sup>10</sup> and requires broker-dealers to become members of at least one self-regulatory organization (SRO).<sup>11</sup> The primary SRO regulating broker-dealers is the Financial Industry Regulatory Authority (FINRA), which oversees over 5,100 broker-dealers.<sup>12</sup> Although the Investment Advisers Act exempts broker-dealers from the Act and its numerous obligations, FINRA imposes duties on its members.<sup>13</sup> Broker-dealers and their registered representatives must also register with states.<sup>14</sup>

### *B. U.S. Regulatory Scheme: Obligations on Intermediaries*

The subsections below outline the different regulatory regimes governing broker-dealers and investment advisers. Broker-dealers and investment advisers share many of the same obligations; the key difference is that investment advisers must discharge a fiduciary duty to clients, whereas broker-dealers need only discharge a suitability duty.

#### **1. Investment Advisers**

Investment advisers in the United States typically manage discretionary, fee-based investment accounts for clients.<sup>15</sup> Investment advisers often act as financial planners for their clients and, unlike broker-dealers, cannot freely sell securities on a principal basis from their own accounts.<sup>16</sup> Instead, investment advisers must act on behalf of their clients by placing orders with broker-dealers.

The Investment Advisers Act, the Exchange Act and state

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U.S.C. § 80b-2 (2006).

10. Securities Exchange Act of 1934 § 15(a), 15 U.S.C. § 78o(a) (2006).

11. *Id.* §§ 15(b)(8), 15A(b)(14)(C), 15 U.S.C. §§ 78o(b)(8) (2006), 78o-3(b)(14)(C).

12. 913 STUDY, *supra* note 4, at iii.

13. *See, e.g.*, Financial Industry Regulatory Authority (FINRA), NASD RULE 2310 (1990).

14. *See* 913 STUDY, *supra* note 4, at 89–90.

15. *Id.* at 6–7. The SEC staff found that 91.2% of investment adviser-managed assets are in discretionary accounts and that over 95% of investment advisers use fee-based compensation based upon the percentage of assets under management. *Id.*

16. *See* Investment Advisers Act of 1940 § 206(3), 15 U.S.C. § 80b-6 (2006). Section 206(3) prohibits investment advisers from “acting as principal . . . without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.” *Id.*

laws impose extensive obligations on investment advisers. First and most importantly, the Supreme Court of the United States has interpreted the Investment Advisers Act to impose a federal fiduciary standard on investment advisers.<sup>17</sup> The fiduciary standard encompasses the duties of loyalty and care.<sup>18</sup> The duty of loyalty requires the investment adviser to act in “the best interests of its clients, which includes an obligation not to subordinate the clients’ interests to its own.”<sup>19</sup> The investment adviser must eliminate, or at least fully disclose, any material conflicts of interest in order to comply with his duty of loyalty.<sup>20</sup> The duty of care requires the investment adviser to make a “reasonable investigation” to ensure his recommendations are not based on “materially inaccurate or incomplete information.”<sup>21</sup> In order to comply with this duty, investment advisers must make a reasonable investigation into their clients’ needs and objectives, and provide only “suitable” investment advice.<sup>22</sup>

Investment advisers’ obligations under the Investment Advisers Act do not end with the fiduciary duty. Two of the most important regulations include the duty of best execution and the restrictions on principal and cross trading.<sup>23</sup> Although the investment adviser does not typically execute trades himself, the duty of best execution requires him to select a broker-dealer who will provide the best trade execution for his client.<sup>24</sup> The restrictions on principal and cross trading in the Investment Advisers Act recognize the especially acute conflicts of interest inherent in those transaction types.<sup>25</sup> Investment advisers must give written disclosure<sup>26</sup> and get written con-

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17. See *supra* note 6.

18. 913 STUDY, *supra* note 4, at 22.

19. *Id.*

20. *Id.* at 22–24.

21. *Id.* at 22 (citation omitted).

22. *Id.* at 27–28.

23. *Id.* at 24–28.

24. *Id.* at 27–28. The investment adviser should consider both cost and quality in seeking best trade execution and must do ongoing evaluations of the execution he obtains for clients. *Id.*

25. *Id.* at 24–27. An investment adviser acts as principal when she sells securities from her own account, giving rise to the danger of self-dealing. *Id.* at 24–25. An intermediary acts as a cross-trader “where the adviser is also a broker-dealer and executes the client’s orders by crossing the orders with orders of non-advisory clients,” giving rise to a danger that the investment adviser will not act in the advisory client’s best interests. *Id.* at 26.

26. Investment Advisers Act of 1940 § 206(3), 15 U.S.C. § 80b-6 (2006). Disclosure includes not only the principal nature of the transaction, but also the investment adviser’s

sent before each principal transaction,<sup>27</sup> breaking with the discretionary nature of the relationship. Cross trading allows annual instead of transaction-by-transaction disclosure and consent, so long as the investment adviser fulfills certain requirements.<sup>28</sup> Finally, the Investment Advisers Act imposes numerous other obligations on adviser activity, governing areas including aggregation of orders,<sup>29</sup> advertising<sup>30</sup> and disclosure of financial and disciplinary history.<sup>31</sup>

In addition to the Investment Advisers Act, advisers must also comply with the Exchange Act, which prohibits fraud in connection with the purchase or sale of securities.<sup>32</sup> Finally, those investment advisers who do not meet the registration threshold of the Investment Advisers Act must instead register with state regulators.<sup>33</sup> Although the states often impose requirements similar to the Investment Advisers Act, the exact regulatory framework varies by state.<sup>34</sup>

## 2. Broker-Dealers

Broker-dealers in the United States typically manage non-discretionary, commission-based accounts for clients.<sup>35</sup> Broker-dealers provide two basic categories of services, including: (1) brokerage services, in which the intermediary acts as agent, executing trades on behalf of her clients and providing advice with respect to those transactions; and (2) dealer services, in which the intermediary acts as principal, selling securities to her clients from her own account and providing advice.<sup>36</sup>

The Investment Advisers Act exempts broker-dealers from its

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compensation for the transaction.

27. *Id.*

28. 913 STUDY, *supra* note 4, at 26–27.

29. *Id.* at 29.

30. *Id.* at 29–32.

31. *Id.* at 38.

32. *See supra* text accompanying note 7.

33. Investment Advisers Act § 203A, 15 U.S.C. § 80b-3a (2006). Significantly, the Dodd-Frank Act increased the registration threshold from 25 million dollars to 100 million dollars, thereby reducing the number of federally regulated investment adviser firms and increasing the burden on states. 913 STUDY, *supra* note 4, at 17.

34. 913 STUDY, *supra* note 4, at 85.

35. *Id.* at 10–11.

36. *Id.* at 9. This is far from an exhaustive summary of what broker-dealers do; see *infra* Part II.C.1 for a more detailed discussion of broker-dealer business practices.



jurisdiction.<sup>37</sup> Instead, the Exchange Act requires broker-dealers to register with the SEC, at least one SRO<sup>38</sup> and the SIPC.<sup>39</sup> Broker-dealers must comply with state law as well.<sup>40</sup>

FINRA, an SRO, imposes a wide array of obligations on its broker-dealer members. The core obligation broker-dealers owe to their clients is the suitability duty, which requires the broker-dealer to have a “reasonable basis” for the recommendations that he makes to his clients.<sup>41</sup> The broker-dealer must investigate his client’s financial situation, tax status and investment objectives in order to form a reasonable basis for his recommendations.<sup>42</sup> In addition to the suitability duty, FINRA requires members to deal honestly and fairly with their clients,<sup>43</sup> to disclose material conflicts of interests,<sup>44</sup> to obtain best execution of trades,<sup>45</sup> to ensure employee competency<sup>46</sup> and to receive only fair compensation for their services.<sup>47</sup> FINRA requires members to arbitrate customer disputes and will remove members who fail to pay monetary awards.<sup>48</sup>

The Exchange Act also imposes numerous obligations on broker-dealers, including the prohibition on deception in connection with the purchase or sale of securities.<sup>49</sup> This antifraud provision also limits the mark-ups that broker-dealers may charge<sup>50</sup> and imposes ex-

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37. See *supra* note 9.

38. See Securities Exchange Act of 1934 § 15(a), 15 U.S.C. § 78o(a) (2006).

39. See *id.* § 15(b)(8), 15 U.S.C. § 78o(b)(8) (2006).

40. 913 STUDY, *supra* note 4, at 89–90.

41. FINRA, NASD Rule 2310 (1990).

42. *Id.*

43. FINRA, NASD Rule 2010 (1990).

44. FINRA, NASD Rules 2720, 3040 (1990).

45. FINRA, NASD Rule 2320 (1990).

46. FINRA, NASD Rules 1000, 1020 (1990).

47. FINRA, NASD RULE 2440 (1990). FINRA follows a flexible “5 Percent Policy,” generally requiring that markups or markdowns not exceed five percent and applying a seven-factor test to determine whether the markup is “fair or reasonable.” 913 STUDY, *supra* note 4, at 66–67 n.303.

48. 913 STUDY, *supra* note 4, at 80.

49. See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); 17 C.F.R. 240.10b-5 (2011). .

50. See 913 STUDY, *supra* note 4, at 67 n.303. “The Commission has consistently held that undisclosed markups of equities of more than 10% above the prevailing market price are fraudulent.”

tensive disclosure obligations for conflicted transactions.<sup>51</sup>

In addition to federal regulations, state laws govern the conduct of broker-dealers. Most importantly, some states impose a fiduciary duty on broker-dealers who have discretionary control over client accounts,<sup>52</sup> given the trust-based nature of the client relationship.<sup>53</sup> Although the Investment Advisers Act does not govern broker-dealers, and therefore does not impose its fiduciary duty upon them, fiduciary duty claims under state law constitute the most common claims in arbitration cases filed under FINRA.<sup>54</sup>

### 3. Dual Registrants

Some financial services firms register as both investment advisers and broker-dealers, providing both kinds of services and complying with both kinds of regulation; some clients maintain both investment advisory and brokerage accounts at the same dual-registered firm in order to pursue different kinds of investing activities.<sup>55</sup> This fact illustrates the differences between broker-dealer and investment adviser business models: a client might use his broker-dealer to pursue “buy-and-hold” strategies<sup>56</sup> or purchase proprietary products on a principal basis,<sup>57</sup> while the same client would use his investment adviser to receive advice on an ongoing basis or pursue

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51. *Id.* at 55.

52. States vary widely in their approach to imposing fiduciary duties on broker-dealers. See 913 STUDY, *supra* note 4, at 54 n.244.

53. See *Davis v. Merrill Lynch, Pierce, Fenner & Smith*, 906 F.2d 1206, 1215–16 (8th Cir. 1990) (holding that the existence of a fiduciary duty is a matter of state law and depends on the nature of the relationship between broker and client). Courts typically hold that brokers owe their clients a fiduciary duty when they “exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers.” 913 STUDY, *supra* note 4, at 54.

54. FINRA, *Dispute Resolution Statistics*, <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm> (last visited Feb. 18 2011). In 2010, clients filed 3,162 breach of fiduciary arbitration cases, significantly exceeding other common claims like negligence and misrepresentation.

55. See 913 STUDY, *supra* note 4, at 12–13.

56. *Id.* at 13. If a client trades infrequently, the broker-dealer’s commission-based compensation structure will be more cost-effective than the investment adviser’s fee-based compensation structure because the client will only have to pay one commission instead of ongoing fees.

57. *Id.* Investment advisers are less likely to provide these products because of the Investment Advisers Act’s restrictions on principal trading and its imposition of a fiduciary duty. See Investment Advisers Act of 1940 § 206(3), *supra* note 26, and accompanying text.

an active trading strategy.<sup>58</sup> The regulatory restrictions and compensation structure of the service provided, therefore, shapes the capacity in which dual registrants act for particular clients.

### *C. U.S. Regulatory Scheme: Obligations on Issuers*

The Securities Act of 1933 (the “Securities Act”) and the Exchange Act impose disclosure-based obligations on issuers with respect to the issuance of securities. The Securities Act requires issuers to disclose financial and other information about their companies and the securities they are issuing.<sup>59</sup> In addition, the Securities Act ensures the veracity of this information by prohibiting deceit and misrepresentation.<sup>60</sup> The Exchange Act imposes ongoing corporate reporting requirements on issuers with more than 10 million dollars in assets whose securities are held by more than 500 people.<sup>61</sup> Like the Securities Act, the Exchange Act uses antifraud provisions to ensure the veracity of company-disclosed information.<sup>62</sup>

After companies have issued securities in the United States, intermediaries have access to the full menu of publicly disclosed information mandated by the Securities Act and Exchange Act. However, the legal obligations of issuers to intermediaries end there. Intermediaries must make “suitability” or “best interests” determinations for their customers based on their analysis of whatever information has been disclosed.<sup>63</sup> However, U.S. laws do not require issuers to work with intermediaries on these determinations or provide recommendations about what kinds of customers are best suited for the securities that they issue.

### *D. U.S. Regulatory Scheme: Obligations on Investors*

The U.S. regulatory framework assumes that all individual investors need the same basic protections afforded by federal, state

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58. 913 STUDY, *supra* note 4, at 13. If the client wants to trade frequently, the investment adviser’s fee-based compensation structure will be more cost-efficient than the broker-dealer’s transaction-based compensation structure.

59. See Securities Act of 1933 § 7, 15 U.S.C. § 77g (2006).

60. See *id.* § 11, 15 U.S.C. § 77k (2006).

61. See Securities Exchange Act of 1934 §§ 12–13, 15, 15 U.S.C. §§ 78l–78m, 78o (2006).

62. See *id.* § 10, 15 U.S.C. § 78j (2006).

63. See discussion *supra* Part I.B.

and SRO regulation.<sup>64</sup> Although FINRA makes special carve-outs for institutional investors and high-net-worth individuals,<sup>65</sup> it protects all other individuals the same way, regardless of investment experience and expertise. However, some courts and arbiters have been hesitant to give large awards to sophisticated investors who allege that unscrupulous intermediaries duped them.<sup>66</sup> Therefore, to some extent, the common law requires sophisticated investors to protect themselves from crooked broker-dealers or unsuitable investments.<sup>67</sup>

### *E. Overview of the EU Regulatory Scheme*

The MiFID regime that governs the secondary market in the EU is a recent innovation, replacing the Investment Services Directive on November 1, 2007.<sup>68</sup> MiFID aims to harmonize secondary market regulation across European Economic Area (EEA) member states, thereby increasing efficiency and consumer protection.<sup>69</sup> Unlike the United States, the MiFID regime does not place intermediaries into different categories with corresponding differences in regulation. Instead, MiFID employs a complex system of client classification, where different investors receive different levels of protection based on their financial size, sophistication and preferences.<sup>70</sup>

Just as state regulation overlaps with federal regulation in the United States, national regulation overlaps with MiFID in several key

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64. See, e.g., *In re Scientific Control Corp. Sec. Litig.*, 71 F.R.D. 491, 512 (S.D.N.Y. 1976) (“As a general matter, the securities laws do not distinguish between sophisticated and unsophisticated investors; both are entitled to the protections of its disclosure and antifraud provisions.”).

65. See FINRA, NASD RULES 2310, 4512(c)(3) (1990) (exempting institutional investors and high-net-worth individuals holding assets over 50 million dollars).

66. See Edward Pekarek & Christian Obremski, *Is the Sophisticated Investor Theory Still Relevant?*, N.Y. STATE BAR ASS’N SEC. LITIG. & ARB. BLOG (Feb. 2, 2011), [http://nysbar.com/blogs/SecuritiesLitigation/2011/02/is\\_the\\_sophisticated\\_investor.html](http://nysbar.com/blogs/SecuritiesLitigation/2011/02/is_the_sophisticated_investor.html).

67. *Id.*

68. Parliament and Council Directive 2004/39/EC, On Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC, 2004 O.J. (L 145) 1 [hereinafter MiFID Directive].

69. *Id.*

70. See Marc Kruithof & Walter Van Gerven, *A Differentiated Approach to Client Protection: The Example of MiFID* 11–16 (U. of Ghent Fin. L. Inst. Working Paper Series WP 2010-7, 2010), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1622682](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1622682).

areas. MiFID gives financial services firms a “passport” to operate across EEA member states.<sup>71</sup> MiFID exempts certain kinds of intermediaries, however, requiring those firms to seek national registration instead.<sup>72</sup>

#### *F. EU Regulatory Scheme: Obligations on Intermediaries*

MiFID imposes obligations on intermediaries based on a complex customer categorization system. There are four customer categories under MiFID, each with a different level of protection: retail clients, elective professional clients, *per se* professional clients and eligible counter-parties (ECPs).<sup>73</sup> ECPs include only the largest and most sophisticated institutional investors.<sup>74</sup> *Per se* professionals are investors who are not ECPs, but meet a defined threshold of size, sophistication and/or experience.<sup>75</sup> All other investors are retail clients by default.<sup>76</sup>

In some circumstances, investors may elect to change customer categories. Retail clients may opt up to elective professional status, thus waiving certain protections attached to retail client status.<sup>77</sup> Similarly, *per se* and elective professional investors may opt down to retail client status, thus gaining extra protections.<sup>78</sup> Clients may opt up or down for all services, or they may elect to do so only in respect to particular products or transactions.<sup>79</sup>

MiFID imposes business obligations on intermediaries that vary in accordance with client category.<sup>80</sup> First, intermediaries must

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71. CTR. FOR EUROPEAN POL’Y STUDIES, MiFID 2.0: CASTING NEW LIGHT ON EUROPE’S CAPITAL MARKETS 24–25 (2011), <http://www.ceps.eu/book/mifid-20-casting-new-light-europe’s-capital-markets> [hereinafter MiFID 2.0].

72. See MiFID Directive, *supra* note 68, arts. 2–3, at 8–9.

73. MiFID does not explicitly distinguish between elective professional clients and *per se* professional clients as separate categories. For the purposes of analytical clarity, however, the Author will treat them as distinct categories. Other commentators have also made this distinction and the Author borrows their language here. See, e.g., Kruithof & Van Gerven, *supra* note 70, at 11–16.

74. See MiFID Directive, *supra* note 68, art. 24(1), at 20.

75. *Id.*, Annex II(1).

76. *Id.* art. 4(1)(12); see also Kruithof & Van Gerven, *supra* note 70, at 14.

77. Kruithof & Van Gerven, *supra* note 70, at 13.

78. *Id.* at 15–16.

79. *Id.*

80. Only ECPs do not benefit from any conduct of business obligations. See MiFID

“act honestly, fairly and professionally in accordance with the best interests of [their] clients.”<sup>81</sup> Second, when the intermediary provides investment advice or portfolio management, she must only recommend or select securities that are suitable for the investor based on an investigation of the investor’s investment objectives, financial situation and investment experience.<sup>82</sup> The extent of the suitability determination depends on the customer category.<sup>83</sup> Intermediaries may not provide unsuitable products or services, regardless of customer demands.<sup>84</sup> When intermediaries provide services that do not involve investment advice or portfolio management,<sup>85</sup> they need only ensure that the product or service they provide is appropriate for the client.<sup>86</sup> Appropriateness demands less than suitability: the intermediary need only make a cursory investigation into the client’s background, and the intermediary is not liable for providing inappropriate products if she warns the client first.<sup>87</sup> Finally, when intermediaries provide execution-only services with respect to certain non-complex and liquid products at the request of customers, they need not provide a suitability or appropriateness determination.<sup>88</sup>

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Directive, *supra* note 68, Directive 2004/39, art. 24(1).

81. *Id.* art. 19(1).

82. MiFID Implementing Directive, Directive 2006/73, art. 35, 2006 O.J. (L 241) 26 (EC); MiFID Directive, *supra* note 68, Directive 2004/39, art. 19(4).

83. Intermediaries may assume that elective professional customers have the requisite investment experience and knowledge to understand the risks involved in all products. Moreover, intermediaries may assume that per se professional customers have the necessary investment experience and knowledge *and* that they are able to bear the investment risks of the selected products. See MiFID Implementing Directive, *supra* note 82, Directive 2006/73, art. 35.

84. *Id.*

85. For example, an intermediary could provide trade execution with only incidental advice.

86. MiFID Directive, *supra* note 68, Directive 2004/39, art. 19(5).

87. MiFID Implementing Directive, *supra* note 82, Directive 2006/73, art. 36; MiFID Directive, *supra* note 68, Directive 2004/39, art. 19(5). Making an appropriateness determination only requires the intermediary to request information regarding the customer’s experience and knowledge with respect to the product or service provided; moreover, intermediaries do not need to request this information from elective and per se professional customers. See MiFID Directive, *supra* note 68, Directive 2004/39, art. 19(5). If the customer refuses to provide the information, the intermediary may still proceed after he gives a warning. *Id.* Even if the intermediary believes the product is inappropriate for the customer, he may still provide it if he gives a clear warning first. *Id.*

88. MiFID Directive, *supra* note 68, Directive 2004/39, art. 19(6). The service or product must be requested by the customer at her own initiative and the customer must be

In addition to its conduct of business obligations, MiFID imposes several other obligations on intermediaries with respect to retail and professional investors. Intermediaries must take reasonable precautions to identify, mitigate and disclose conflicts of interest,<sup>89</sup> “take all reasonable steps” to achieve the best execution of trades,<sup>90</sup> ensure that all customer communications and marketing campaigns are fair and not misleading,<sup>91</sup> and provide extensive disclosure on the firm’s services, strategies, execution venues, costs and compensation approach.<sup>92</sup>

### *G. EU Regulatory Scheme: Obligations on Issuers*

The EU places disclosure-based obligations on issuers. The Prospectus Directive requires the issuer to disclose certain information about the firm and about the security it is issuing, including its “essential risks and characteristics.”<sup>93</sup> The Prospectus Directive exempts certain kinds of issuances from regulation,<sup>94</sup> but the exemptions do not affect most large issuances that end up in the secondary market. Like the United States, the EU does not impose any special obligations on issuers to disclose the suitability or appropriateness of their products for different kinds of customers, placing most of the burden on intermediaries.

### *H. EU Regulatory Scheme: Obligations on Investors*

Unlike the U.S. system, MiFID explicitly places certain duties on sophisticated investors, alleviating the burden on intermediaries. First, MiFID places burdens on investors with respect to accurate

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informed that the intermediary will not conduct a suitability determination and have its corresponding protections. Article 19(6) reiterates, however, that the intermediary must still comply with its conflict of interest obligations under MiFID Directive, *supra* note 68, Directive 2004/39, art. 18.

89. MiFID Directive, *supra* note 68, Directive 2004/39, art. 18. The MiFID Implementing Directive also imposes special obligations related to compensation, supervision and organization in order to prevent conflicts of interest. See MiFID Implementing Directive, *supra* note 82, Directive 2006/73, art. 22.

90. MiFID Directive, *supra* note 68, Directive 2004/39, art. 21.

91. *Id.* art. 19(2).

92. *Id.* art. 19(3).

93. Prospectus Directive, Directive 2003/71, art. 5, 2003 O.J. (L 345) 64 (EC).

94. *Id.* art. 4.

customer classification. After a retail client has chosen to opt up to elective professional client status, she has that classification with respect to all products and services. If she would like to opt back down and receive greater protection, she must notify the intermediary herself.<sup>95</sup> Second, MiFID shifts part of the suitability or appropriateness determination burden to investors by allowing intermediaries to assume that professional investors have the necessary expertise and ability to bear risk.<sup>96</sup> Retail clients do not, however, bear any special obligations under MiFID.

## II. ARGUMENTS AGAINST THE UNIFORM FIDUCIARY STANDARD

### *A. The Problem: The Uniform Fiduciary Standard Decreases Harmony with the EU System and Threatens Legitimate Broker-Dealer Business Models*

Section 913<sup>97</sup> of Dodd-Frank authorizes the Commission to conduct a study (the 913 Study) and promulgate a rule establishing a uniform fiduciary standard for intermediaries who provide personalized investment advice<sup>98</sup> about securities to retail investors.<sup>99</sup> The

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95. See Kruithof & Van Gerven, *supra* note 70, at 13–14; see also MiFID Directive, *supra* note 68, Directive 2004/39, Annex II(2). MiFID does not require the intermediary to make any additional investigations after he has classified a customer as an elective professional client. However, if the intermediary becomes aware that the client no longer meets the necessary qualifications, he must reclassify the customer. Kruithof & Van Gerven, *supra* note 70, at 14.

96. See *supra* notes 83, 87 and accompanying text. MiFID effectively shifts part of the suitability determination to elective professional customers, an even greater part of the suitability determination to per se professional customers and *all* of the appropriateness determination to professional customers. Moreover, MiFID shifts *all* the burden to clients for certain kinds of execution-only transactions when certain conditions are met. See *supra* note 88 and accompanying text.

97. The Dodd-Frank Wall Street Reform and Consumer Protection Act § 913, 15 U.S.C. § 78o(k) (Supp. 2011).

98. The term “personalized investment advice” excludes impersonal advice. See 913 STUDY, *supra* note 4, at 123. The extent to which the “personalized investment advice” language will limit the imposition of the uniform fiduciary standard is still unclear. SEC Commissioner Luis Aguilar summed up this uncertainty when he said, “I question why [the fiduciary standard] should be limited to ‘personalized services.’ This qualification would narrow the range of clients that would be protected by the fiduciary standard, and I fear that it may become a loophole that would make it easy to avoid putting clients first.” Aguilar Speech 1, *supra* note 1.

99. Although this language explicitly mentions retail investors, it also provides for the



Commission Staff submitted the 913 Study on January 21, 2011, recommending a uniform fiduciary duty for all intermediaries.<sup>100</sup> The 913 Study considered several alternatives<sup>101</sup> but concluded that the uniform fiduciary standard would create the best outcome for investors.<sup>102</sup> The Commission Staff did not unanimously endorse this conclusion; two of the five Commissioners dissented, arguing that a uniform fiduciary standard could harm investors and that the Commission needed more research before making a conclusion.<sup>103</sup>

The sections below will first describe several advantages that the uniform fiduciary standard provides. Next, they will describe several disadvantages of the uniform fiduciary standard and argue that the substantial disadvantages merit pursuing a different approach.

### *B. Advantages of the Uniform Fiduciary Standard*

The 913 Study authors made well-founded arguments regarding the benefits of a uniform fiduciary standard. First, the uniform fiduciary standard would reduce investor confusion.<sup>104</sup> The 913 Study presented survey results showing that most investors do not

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possibility that the Commission may include other kinds of investors (such as institutional investors) within the uniform fiduciary standard. Dodd-Frank § 913(g) amends the Exchange Act to authorize the SEC to:

promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (*and such other customers as the Commission may by rule provide*), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940.

15 U.S.C. § 78o(k) (Supp. 2011) (emphasis added). At least one Commissioner has expressed interest in applying the uniform fiduciary standard to *all* investors. “I question why the protection of the fiduciary standard should be limited to ‘retail’ customers . . . all investors, including institutional investors, need the protection of the fiduciary standard.” Aguilar Speech 1, *supra* note 1.

100. See 913 STUDY, *supra* note 4, at 165.

101. See *id.* at 143–65. The 913 Study authors rejected the main alternative of removal of the broker-dealer exclusion from the Investment Advisers Act. *Id.*

102. *Id.* at 165. In making this decision, the Commission emphasized that a uniform fiduciary standard would decrease investor confusion, increase investor protection and preserve investor choice. See *id.*

103. See Kathleen Casey & Troy Paredes, Comm’rs, SEC, Statement Regarding Study on Investment Advisers and Broker-Dealers (Jan. 21, 2011) (transcript available at <http://www.sec.gov/news/speech/2011/spch012211klctap.htm>).

104. See 913 STUDY, *supra* note 4, at 94–95.

understand the differences between investment advisers and broker-dealers, nor do they understand the differences in regulatory requirements.<sup>105</sup> Moreover, most investors believe that all intermediaries are in fact required to act in their clients' best interest and that they should be required to act in such a way.<sup>106</sup> The Commission rightly concluded that investors do not understand the bifurcated regulatory regime governing investment advisers and broker-dealers and that the uniform fiduciary standard would remove much of this confusion.<sup>107</sup>

Secondly, the Commission argues that holding broker-dealers to a lower standard gives rise to opportunities for regulatory arbitrage.<sup>108</sup> The days when broker-dealers did not provide investment advice have long passed—today, many broker-dealers provide extensive advice to clients.<sup>109</sup> The net result is that broker-dealers may provide the same services to the same investors at a lower regulatory cost than investment advisers. Promulgating a uniform fiduciary standard rule would eliminate this loophole and level the playing field for investment advisers.<sup>110</sup>

Finally, and less persuasively, the Commission argues that the uniform fiduciary standard would preserve investor access to the full menu of broker-dealer services that they currently enjoy.<sup>111</sup> While it is true that the uniform fiduciary standard would be less disruptive than other alternatives that the Commission considered,<sup>112</sup> the Com-

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105. *Id.* at 95–101.

106. *Id.* at 95, 98.

107. *Id.* at 165. No uniform federal standard could completely eliminate investor confusion, however, so long as regulation at the state and federal levels differs considerably. *See supra* notes 33–34 and accompanying text.

108. 913 STUDY, *supra* note 4, at 104.

109. *Id.* *See also* Luis Aguilar, Comm'r, SEC, Statement in Support of Extending a Fiduciary Duty to Broker-Dealers Who Provide Investment Advice (May 11, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch051110laa.htm>).

110. Two important caveats apply. First, some state laws already impose a fiduciary duty on broker-dealers under certain circumstances. *See supra* notes 52–54 and accompanying text. Second, in some areas broker-dealers actually have higher regulatory costs than investment advisers, including continuing education and competency requirements. *See* 913 STUDY, *supra* note 4, at 164. However, the 913 Study recommends considering the harmonization of these requirements as well. *Id.* at 165–66.

111. *Id.* at 165.

112. Removing the broker-dealer exclusion from the Investment Advisers Act would impose an even greater burden on broker-dealer business practices because it would subject broker-dealers to provisions like § 206(3), which places restrictions on principal trading. *See* Investment Advisers Act of 1940 § 206(3), 15 U.S.C. § 80b-6 (2006); *id.* at 146–51.

mission takes an overly optimistic view of the compatibility of the fiduciary standard with broker-dealer business models.<sup>113</sup>

### *C. Disadvantages of the Uniform Fiduciary Standard*

A uniform fiduciary standard would have two serious disadvantages: first, it would stifle legitimate broker-dealer business models, and second, it would decrease regulatory harmony with the EU. As discussed in more detail below, this result would raise costs for investors, decrease investor choice and increase confusion at the international level.

#### **1. The Uniform Fiduciary Standard Stifles Broker-Dealer Business Models**

Broker-dealers engage in many legitimate business practices that fundamentally clash with the requirements of the fiduciary duty. Using non-discretionary accounts with transaction-based compensation, underwriting, principal trading and execution-only transactions would all become endangered practices if the Commission imposes a fiduciary duty on broker-dealers. Yet these practices increase liquidity and provide significant cost advantages to investors.<sup>114</sup> The following subsections will describe the broker-dealer business practices that would be threatened by a uniform fiduciary standard and explain how they contribute to liquidity and cost reduction.

##### *a. Transaction-Based Compensation*

Transaction-based compensation and non-discretionary accounts are core features of most broker-dealer businesses.<sup>115</sup> Transaction-based compensation incentivizes broker-dealers to execute as many trades as possible<sup>116</sup> and to prefer trades that incur higher

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113. See discussion *infra* Part II.C.1.

114. See, e.g., Letter from Marc Menchel, Executive Vice President and General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, SEC (Aug. 25, 2010) (available at <http://www.sec.gov/comments/4-606/4606-1924.pdf>) [hereinafter FINRA Letter].

115. See *supra* note 35 and accompanying text.

116. When done to a fraudulent extent, this practice is known as “churning” and gives rise to an action for fraud under § 10(b) of the Exchange Act. “Churning occurs when a securities broker enters into transactions and manages a client’s account for the purpose of generating commissions and in disregard of his client’s interests.” *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 324 (5th Cir. 1981).

markups.<sup>117</sup> This compensation structure works well with non-discretionary accounts because the intermediary must obtain consent before executing trades; the broker-dealer's lack of discretion acts as a check on his natural incentives to trade more.

Principal-agent theory supports matching transaction-based compensation and non-discretionary accounts.<sup>118</sup> Although the broker-dealer does not act as a fiduciary, the investor (the "principal") has significant control over the actions of the broker-dealer (the "agent").<sup>119</sup> Conversely, discretionary accounts match best with fee-based compensation and a fiduciary duty. The fee-based compensation structure removes the incentive to "churn,"<sup>120</sup> and the fiduciary duty keeps the agent's discretion in check.<sup>121</sup>

A fundamental mismatch between incentives and duties arises when a transaction-based compensation, non-discretionary account combines with a fiduciary duty or when a fee-based compensation, discretionary account lacks a fiduciary duty. However, the uniform fiduciary standard would give rise to the former situation, notwith-

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117. Less liquid securities will have higher execution costs and therefore give rise to higher commissions. See, e.g., Michael Goldstein et al., *An Analysis of Liquidity Across Markets: Execution Costs on the NYSE Versus Electronic Markets* (Accepted Paper Ser., Apr. 17, 2008), available at <http://ssrn.com/abstract=1713097>; see also Hendrik Bessembinder & Kumar Venkataraman, *Bid-Ask Spreads: Measuring Trade Execution Costs in Financial Markets* (Mar. 2009), available at <http://kvenkataraman.cox.smu.edu/papers/BVEQF.pdf>.

118. "[W]hen the broker-dealer recommends that a client consider purchasing a particular security . . . the investor retains the discretion to decide whether to purchase the security. This remains a far cry from the paradigm case for imposing heightened duties: the investment adviser that has discretionary authority over the client's funds." Moloney et al., *Fiduciary Duties, Broker-Dealers and Sophisticated Clients: A Mis-Match That Could Only Be Made in Washington*, 3 J. SEC. L. REG. & COMPLIANCE 336, 343 (2010); see also MiFID 2.0, *supra* note 71.

119. Moloney et al., *supra* note 118, at 343. In many kinds of broker-dealer transactions, such as when the broker-dealer acts as market-maker, "[i]t is contrary to the nature of this transaction to assume any deference is being provided to the broker-dealer's view." *Id.* at 344.

120. The intermediary will simply increase costs to himself if he trades excessively because he will not be able to pass on the costs to the customer as he would in a commission-based account. Fee-based accounts still pose the danger of "reverse churning," however, in which the intermediary intentionally under-trades to the detriment of the client in order to keep his costs down. See Letter from Joan Hinchman, Executive Director, President and CEO, Nat'l Soc'y of Compliance Professionals, to Elizabeth Murphy, Secretary, SEC (Aug. 30, 2010) (available at <http://www.sec.gov/comments/4-606/4606-2637.pdf>).

121. See Moloney et al., *supra* note 118, at 343.

standing the caveats put in place by Congress and the Commission.<sup>122</sup> Broker-dealers will have natural incentives to trade more, yet the fiduciary duty will require them to trade only to the extent that is in the “best interests” of their clients—or face litigation. Even if broker-dealers were capable of suppressing natural competitive incentives, dissatisfied clients will bring suits for breach of fiduciary duty when trades go bad, arguing that the broker-dealer traded too much.<sup>123</sup> This increase in litigation would lead more broker-dealers to shift to fee-based compensation,<sup>124</sup> where incentives are naturally compatible with a fiduciary duty. Such a shift would decrease the supply of intermediaries who provide transaction-based compensation, leading to increased costs for these services and hurting investors whose investment objectives require transaction-based compensation.<sup>125</sup>

*b. Underwriting*

Broker-dealers act as underwriters, distributing newly issued securities through other intermediaries or directly to clients from their principal accounts.<sup>126</sup> In order to garner interest for new issu-

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122. See The Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 § 913, 15 U.S.C. § 78o(k) (“The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer.”); see also 913 STUDY, *supra* note 4, at 113 (arguing that uniform fiduciary standard is “business model-neutral” and will not affect commission-based compensation models of broker-dealers).

123. Numerous commenters expressed concern about this kind of spurious litigation. See, e.g., Letter from NAIFA to Elizabeth Murphy, Secretary, SEC, at 14 (Aug. 30, 2010), available at [www.sec.gov/comments/4-606/4606-2515.pdf](http://www.sec.gov/comments/4-606/4606-2515.pdf) (expressing concern that broker-dealer fiduciary duty would lead to “frivolous litigation” and force many broker-dealers to cease operations). This increase in litigation would cause corresponding increases in insurance costs that would be passed on to customers. See 913 STUDY, *supra* note 4, at 158 n.692.

124. See 913 STUDY, *supra* note 4, at 158.

125. See OLIVER WYMAN, SIFMA, STANDARD OF CARE HARMONIZATION IMPACT ASSESSMENT FOR SEC (Oct. 2010), available at <http://www.sifma.org/workarea/downloadasset.aspx?id=21999>. The study found that a uniform fiduciary standard would lead to broker-dealers shifting to fee-based compensation and would cause serious consequences for retail investors. First, the study predicted that such a shift would lead to a reduction of “cumulative returns to ‘small investor’ [clients] by \$20K over the next 20 years.” *Id.* at 26. The study noted that the average lower-income investor tends to trade infrequently and therefore prefers commission-based accounts, finding that over 90% of lower-income investors use only commission-based accounts. Such a shift to fee-based compensation would hit lower-income investors the hardest. *Id.*

126. See 913 STUDY, *supra* note 4, at 8 n.13.

ances, underwriters engage in a “book-building process” that results in severely oversubscribed IPOs.<sup>127</sup> The underwriter must then be highly selective in regards to which clients ultimately purchase shares, which will result in favoritism toward certain clients.<sup>128</sup> Furthermore, even after underwriters distribute IPO shares to other broker-dealers, they expect those broker-dealers to exhibit favoritism to “strong hands” and will penalize those who fail to do so.<sup>129</sup>

Favoritism<sup>130</sup> from underwriters and other broker-dealers who participate in the IPO market would violate a fiduciary duty. Simply put, an intermediary cannot play favorites and, at the same time, act in the best interests of all his clients. Clients will inevitably complain that their broker-dealer excluded them from a lucrative IPO because they were not preferred clients or because they were not expected to act as strong hands; other clients who do receive IPO shares may complain that their broker-dealer discouraged them from flipping shares even though it was in their best interest. Even if broker-dealers did not play favorites and selected clients on a completely

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127. Mathias Hild, *The Google IPO*, 3 J. BUS. & TECH. L. 41, 43–46 (2008). During the book-building process, underwriters seek nonbinding bids from institutional and retail clients, where they find out how many shares the clients want and how much they would pay. The IPOs become oversubscribed because underwriters must seek bids from far more potential investors than necessary in order to aid price discovery and ensure a favorably priced sale of all the newly issued shares. This results in a “25-to-1 ratio”: for every million shares issued at the offering price, 25 million investors expressed interest in that price. *Id.* Importantly, these practices benefit investors by providing discounted offering prices: “[i]n the period from 1980 to 2001, the offering price was set on average at 18.8% below the market-clearing price.” *Id.* at 46 (citation omitted).

128. The underwriter might award long-standing clients with access to hard-to-get IPO offerings or distribute shares to institutional clients with the hope of receiving additional business in the future. *Id.* at 45.

129. “Strong hands” are investors who will hold onto the newly issued shares and not flip them quickly. *Id.* at 45–46. If a broker-dealer’s clients flip too quickly, the underwriter might penalize the offending broker-dealer by taking back commissions or withholding future issuances. *Id.* at 46. This may ultimately cause broker-dealers to give preference to institutional investors, who receive about two-thirds of IPO shares, because broker-dealers tend to believe that they are more likely to exhibit “strong hand” behavior. *Id.* at 45. This also causes broker-dealers to prefer clients with long-term investing objectives and may also cause broker-dealers to discourage clients from selling shares. *Id.* at 46; *see also* Reena Aggarwal, *Allocation of Initial Public Offerings and Flipping Activity*, 68 J. FIN. ECON. 111, 112–115 (2003).

130. *See* Jonathan Reuter, *Are IPO Allocations for Sale? Evidence from Mutual Funds*, 61 J. FIN. 2289, 2291 (2006) (finding empirical evidence of favoritism in IPO allocation based on business relationships).

random basis,<sup>131</sup> the specter of litigation would loom and deter risk-averse broker-dealers from entering the underwriting market.<sup>132</sup> This would reduce competition among underwriters, thereby increasing spreads, decreasing cheap access to IPOs and ultimately increasing costs to investors.

*c. Principal Trading*

Investment Advisers Act § 206(3) places strict disclosure-and-consent restrictions on principal trading for investment advisers but does not apply to broker-dealers.<sup>133</sup> Although the proposed uniform fiduciary standard would not impose § 206(3) on broker-dealers,<sup>134</sup> the fiduciary duty itself would raise serious conflicts with principal trading practices; acting as a fiduciary requires the agent to subordinate his interests to that of the principal, but principal trading serves both the interests of the broker-dealer and the client.<sup>135</sup>

Principal trading is a crucial part of the broker-dealer business model and restricting it would ultimately increase trading costs and decrease investor choice.<sup>136</sup> Broker-dealers contribute to market li-

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131. Such an assumption is inconceivable in a competitive brokerage market, going against both conventional wisdom and empirical evidence. *See id.* Broker-dealers compete with one another for customers and will use access to scarce products to their advantage.

132. *See Monetta Fin. Servs. v. SEC*, 390 F.3d 952 (7th Cir. 2004). In *Monetta*, the Seventh Circuit noted that if investment adviser MFS gave preferential allocation of IPO shares to certain clients, it would be in violation of its fiduciary duty to act in the best interests of its clients by inequitably distributing IPO shares that “are rare and therefore valuable to investors.” *Id.* at 955. If broker-dealers were held to the same fiduciary duty as investment advisers, they would face similar allegations.

133. *See supra* notes 25–27 and accompanying text. Broker-dealers still must disclose their principal capacity when they act as such, as well as disclose any special compensation they receive from third parties. 913 STUDY, *supra* note 4, at 115, 119.

134. “The omission of a reference to Section 206(3) appears to reflect a Congressional intent not to mandate the application of that provision to broker-dealers.” 913 STUDY, *supra* note 4, at 119.

135. Principal trading benefits investors by lowering execution costs and increasing access to certain types of securities. *See infra* notes 137, 138 and accompanying text. A broker-dealer also serves his own interests by engaging in principal trading, however, by selling from his own account instead of simply acting as an agent for the client. Therefore, “[m]any commenters have expressed concerns about how principal trading would be regulated under the uniform fiduciary standard.” 913 STUDY, *supra* note 4, at 119.

136. *See* FINRA Letter, *supra* note 114 (arguing that a uniform fiduciary standard would restrict principal trading and cause increased investor costs and decreased investor access).

quidity<sup>137</sup> and lower execution costs<sup>138</sup> when they buy securities in bulk and sell them from their own accounts.<sup>139</sup> Principal trading also increases access to illiquid securities for lower-income investors who cannot afford high execution costs, ultimately increasing investor choice for retail investors.<sup>140</sup>

Broker-dealers have a natural incentive to offload securities on their own accounts instead of executing agency trades for clients. While this incentive raises concerns about conflicts of interest, broker-dealer principal transactions are already regulated to address this.<sup>141</sup> The incentives created by principal trading do not match the obligations imposed by a fiduciary standard; broker-dealers who fear litigation will stop principal trading, ultimately raising investor costs, decreasing investor choice and stifling liquidity.

#### *d. Execution-Only Transactions with Incidental Advice*

Broker-dealers often execute transactions at their customers' requests and provide only incidental advice in relation to the transaction.<sup>142</sup> The proposed uniform fiduciary standard would not cover

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137. Intermediaries increase liquidity for issuers when they buy large quantities of securities and hold them before they are ready for distribution to investors. *Id.* If the amount of principal trading decreased, the transaction costs of bringing new issuances to market would increase, ultimately passing higher costs onto consumers.

138. "Bunching," or buying securities in bulk for the principal account, allows the broker-dealer to consolidate his execution costs into a single transaction and then pass those execution savings on to his clients. 913 STUDY, *supra* note 4, at 29. This is especially true for illiquid securities where execution costs are high, such as investment grade corporate debt. *Id.* at 160 n.694. If broker-dealers choose instead to execute each transaction separately and avoid the conflicts of interest inherent in bunching, *see id.* at 29, execution costs would increase dramatically, and many illiquid securities would become unaffordable to lower-income investors. This would not only hit individual investors—who are the primary holders of corporate and municipal debt—but would also hurt municipalities who rely on cheap financing. *See WYMAN, supra* note 125, at 15–21.

139. Broker-dealers try to predict retail demand when they amass inventory on their principal accounts. *Id.* at 21. It would be unrealistic, however, to expect broker-dealers to anticipate their current and future clients' needs such that they could only purchase inventory which is in the "best interests" of every single client and not merely "suitable." Moreover, the savings in execution costs and increase in investor access to bonds are very much in the investors' "best interests."

140. *See id.*; *see also* 913 STUDY, *supra* note 4, at 161.

141. *See supra* note 133.

142. When broker-dealers provide "solely incidental" advice with respect to the purchase or sale of securities, they do not fall under the regulation of the Investment Advisers Act. Investment Advisers Act of 1940, § 202(a)(11), 15 U.S.C. § 80b-2(a)(11)



transactions involving only incidental advice because it is limited to “personalized investment advice.”<sup>143</sup> Courts have not developed a clear distinction between incidental and non-incidental advice, however, and litigious investors can exploit this lack of clarity.<sup>144</sup> The danger of litigation may have the perverse incentive of encouraging broker-dealers not to offer any advice at all for fear of triggering the fiduciary duty.<sup>145</sup> Investors could face an all-or-nothing regime in which they either receive investment advice subject to a fiduciary duty or no advice at all, thereby decreasing the overall information flow to retail customers.

Imposing a uniform fiduciary standard in the United States would stifle legitimate broker-dealer business practices, ultimately decreasing liquidity, increasing investor costs and decreasing investor choice. However, the costs of a uniform fiduciary standard do not end there. A uniform fiduciary standard in the United States would decrease harmony with the EU, which would ultimately dampen international financial services competition, raising costs and decreasing choice for investors in both jurisdictions.

## 2. The Uniform Fiduciary Standard Decreases Harmony with the EU

The suitability standard is the key similarity between the United States’ and the EU’s regulatory regimes.<sup>146</sup> This similarity would disappear with the imposition of a uniform fiduciary standard in the United States. Differences between the two regimes that were

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(2006).

143. See 913 STUDY, *supra* note 4, at 29.

144. See Moloney et al., *supra* note 118, at 344 (“[I]t will be a difficult task to apply [the personalized investment advice] test to a broker-dealer’s daily activities . . . . [S]uch an imprecise dictate would likely lead to fear of an overbroad application, and a chilling effect that reduces beneficial economic activity.”).

145. See *id.*; see also FINRA Letter, *supra* note 114.

146. To the extent that intermediaries in the EU may act as broker-dealers for U.S. customers, they share the suitability standard. Of course, to the extent that EU intermediaries fall within the definition of “investment adviser” under the Investment Advisers Act, they would be subject to the fiduciary duty. See Investment Advisers Act of 1940 § 206(a)(11), 15 U.S.C. § 80b-2(a)(11) (2006) (“‘Investment adviser’ means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.”).

already stark<sup>147</sup> would become insuperable.

Decreasing regulatory harmony between the United States and the EU would have several consequences that would ultimately result in higher costs and fewer choices for investors. First, firms that wish to operate in both jurisdictions would need to maintain two entirely different systems with respect to compliance, supervision and training.<sup>148</sup> Firms that cannot afford two systems would confine themselves to their home market, decreasing cross-border investment firm competition; firms that can afford two systems would pass on higher regulatory costs to consumers. Whether firms withdraw or pass on higher fees, the net result would be higher costs and fewer choices for investors. Second, raising barriers to cross-border intermediary activity would aggravate the “home bias”<sup>149</sup> of investors. Investors would be limited to investment services from intermediaries in their home market, losing the benefits of cross-border flows of products and information. Home bias ultimately results in suboptimal investment strategies,<sup>150</sup> and investors in both the United States and the EU already suffer from significant home bias.<sup>151</sup> Finally, decreasing regulatory harmony between the United States and the EU would cause ripple effects throughout both economies that would hurt consumers. For example, less cross-border investment would mean fewer liquid markets for issuers. In order to distribute their products, issuers would need to allow intermediaries to take higher

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147. Examples of key differences include the appropriateness standard in the EU, *see supra* notes 86–87 and accompanying text, the execution-only standard in the EU, *see supra* note 88 and accompanying text, and the fiduciary standard for investment advisers in the United States, *see supra* notes 17–22 and accompanying text.

148. Only large firms would have the necessary economies of scale to be able to afford such a dual system. Of course, international firms already need to do this but not to the extent that would be required if there were a uniform fiduciary standard in the United States.

149. Financial theory predicts that investors would “hold the world market portfolio of risky assets, irrespective of their country of residence” in order to maximize returns; notwithstanding this principle, investors skew strongly towards domestic holdings, creating a paradoxical “home bias.” Alan G. Ahearne et al., *Information Costs and Home Bias: An Analysis of U.S. Holdings of Foreign Equities* 1 (FRB Int’l Fin. Discussion Paper No. 691, May 2001), available at [http://papers.ssrn.com/sol3/Delivery.cfm/SSRN\\_ID260228\\_code010215130.pdf?abstractid=260228&mirid=1](http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID260228_code010215130.pdf?abstractid=260228&mirid=1). U.S. investors suffer from significant home bias. *Id.* at 2.

150. *Id.* at 1.

151. *Id.* at 2; *see also* Catherine L. Mann & Ellen E. Meade, *Home Bias, Transaction Costs, and Prospects for the Euro: A More Detailed Analysis* (Int’l Fin. Stability Programme at the Ctr. for Econ. Performance, London Sch. of Econ. and Political Sci. Working Paper), available at <http://www.iie.com/publications/wp/02-3.pdf>.

spreads, resulting in less value for investors.

The uniform fiduciary standard would decrease regulatory harmony with the EU, leading to increased regulatory costs, decreased cross-border competition, aggravated home bias and less overall liquidity. Ultimately, consumers would have to pay more for services and would have fewer products from which to choose. Although the uniform fiduciary standard could provide considerable benefits,<sup>152</sup> they are not worth the costs that would result from stifling broker-dealer business practices and decreasing cross-border regulatory harmony.

### III. ALTERNATIVES TO THE UNIFORM FIDUCIARY STANDARD

#### *A. The Solution: Proposal for a Transatlantic Investor Protection Regime*

The bifurcated regulation in the United States weakens investor protection. Yet the uniform fiduciary standard provides a cure worse than the disease by raising costs and decreasing choice for investors. Regulators do not need to choose between protection and cost, however; instead, a harmonized transatlantic investor protection regime could satisfy the concerns of both proponents and opponents of the uniform fiduciary duty.

Why harmonize the regimes? First, increased cross-border regulatory harmony means greater investment firm competition, less home bias and more cross-border liquidity, ultimately resulting in lower costs and greater choice for investors.<sup>153</sup> Second, the United States can close the loopholes inherent in its current system by shifting away from an intermediary classification approach and toward a customer classification approach, which would result in greater harmony with MiFID.<sup>154</sup> Third, shifting to customer classification in the United States would preserve legitimate broker-dealer business practices without sacrificing meaningful protection for unsophisticated retail investors. By focusing on client classification and the nature of the relationship between the investor and the intermediary, the United States and the EU can harmonize their regimes and increase both protection and efficiency.

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152. See discussion *supra* Part II.B.

153. See discussion *supra* Part II.C.2.

154. See discussion *infra* Part III.B.1.a.

## *B. The Harmonized Transatlantic Investor Protection Regime*

The following sections will outline a proposal for a harmonized transatlantic investor protection regime, describing the obligations that should be imposed on intermediaries, issuers and investors. Each section will explain how the proposed approach would satisfy the concerns of both proponents and opponents of the uniform fiduciary standard. First, this Note discusses obligations on intermediaries, arguing that the United States should eliminate intermediary category-based regulation and adopt MiFID's customer classification scheme. Second, the Note argues that the obligations imposed on intermediaries should be based upon the nature of the relationship between the investor and the intermediary; the level of the intermediary's discretion and the compensation structure define this relationship. Third, the Note discusses obligations on issuers, arguing that the United States and the EU should shift away from their purely disclosure-based models and require issuers to provide information to intermediaries on the suitability of their products for different kinds of investors. Finally, the Note discusses investor obligations, arguing that the United States should adopt a modified version of the EU's elective professional client regime. If the United States and the EU took these steps, they would enjoy the benefits of a fully harmonized investor protection regime.

### *1. Obligations on Intermediaries*

The United States's and the EU's regulation of intermediaries overlap in several areas.<sup>155</sup> The regimes differ, however, in two key areas. First, the United States uses an intermediary category-based regulation approach while the EU uses a client category-based regulation approach.<sup>156</sup> Second, the basic duty owed to clients differs.<sup>157</sup> The United States and the EU must agree on common standards in these two key areas in order to achieve meaningful harmonization. The following sub-sections will describe how the United States and the EU can harmonize these two areas while addressing the concerns of both proponents and opponents of the uniform fiduciary duty.

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155. Among other examples, both regimes require conflicts of interest disclosure, and both prohibit false and misleading advertising and communications. *See* discussion *supra* Parts I.C, I.G.

156. *See* discussion *supra* Parts I.C, I.G.

157. *See* discussion *supra* Parts I.C, I.G.

a. *Eliminate Intermediary Category-Based Regulation and Standardize Client Category-Based Regulation*

Intermediary category-based regulation causes investor confusion and creates regulatory loopholes. Client category-based regulation, on the other hand, creates a system of proportional regulation in which the level of regulatory burden depends upon the size, sophistication and experience of the client.<sup>158</sup> The United States should adopt MiFID's customer classification system in order to harmonize the regimes and address the concerns of both proponents and opponents of the uniform fiduciary standard.

Switching to customer category-based regulation would address uniform fiduciary proponents' concerns. Intermediary category-based regulation caused investor confusion and regulatory loopholes because broker-dealers could essentially provide the same services to the same clients as investment advisers, without being subject to the same fiduciary duty as investment advisers would be.<sup>159</sup> Customer category-based regulation ensures that all intermediaries must discharge the same duties when providing the same services to the same clients.<sup>160</sup> This not only eliminates possibilities for regulatory arbitrage, but also provides a much clearer picture for retail investors. A retail investor would always enjoy the same protection while receiving investment advice, unless she chose to become an elective professional client. Given the qualifications required and process involved in becoming an elective professional client,<sup>161</sup> it is unlikely that such clients would be confused when they receive elective professional client status.

Switching to a customer category-based regulation regime would also address the concerns of uniform fiduciary standard opponents, to the extent that it carves out exemptions from the fiduciary duty and therefore preserves legitimate broker-dealer business mod-

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158. MiFID aims to achieve *proportionality* through "business rules [that] differentiate in their application between several types of clients that require different forms and intensity of protection." Kruithof & Van Gerven, *supra* note 70, at 3–4.

159. See Aguilar Speech 1, *supra* note 1.

160. In other words, under MiFID an intermediary must discharge the suitability duty when it provides investment advice to a retail client, regardless of what kind of intermediary is providing the advice. The duty only changes when the type of client or type of transaction changes. See discussion *supra* Part I.G.

161. The process is initiated by the investor and requires meaningful disclosures on the part of both the investor and the intermediary. See discussion *supra* Part I.G.

els.<sup>162</sup> Even if the harmonized standard were to impose a fiduciary duty with respect to retail investors under certain circumstances,<sup>163</sup> the harmonized standard might impose a lower duty with respect to elective professional and per se professional clients and may also impose a lower duty with respect to certain kinds of non-discretionary transactions.<sup>164</sup> In these areas, where the fiduciary standard does not apply, broker-dealers would still be able to engage in crucial practices like transaction-based compensation, underwriting and principal trading.<sup>165</sup> In other words, intermediaries would still be able to engage in broker-dealer business practices when appropriate and would only be precluded from doing so where the nature of the client or transaction makes a fiduciary duty necessary.

Even if the United States and the EU harmonize their regimes by eliminating intermediary-based regulation and adopting MiFID's customer category-based regulation, three important questions remain: (1) what duty would be owed, (2) to which clients and (3) under what circumstances? The next section argues that those questions should be answered by focusing on the nature of the relationship between the investor and the intermediary. This approach should satisfy both proponents and opponents of the uniform fiduciary standard.

*b. Harmonize Duties Owed to Investors Based Upon the Nature of the Relationship*

There are two key components of the relationship between investors and intermediaries: the level of discretion and the compensation structure. Discretion matters because an intermediary with discretion enjoys a trust-based relationship with the investor while an intermediary without discretion does not.<sup>166</sup> Compensation structure matters because it creates strong incentives to engage in certain trading behaviors.<sup>167</sup> Regulators should match intermediary discretion with compensation structure in order to align intermediary duties with trading incentives.<sup>168</sup> The United States and the EU can align duties with incentives by crafting a regime that (1) matches discre-

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162. See discussion *supra* Part II.C.1.

163. See discussion *infra* Part III.B.1.b.

164. See *id.*

165. See discussion *supra* Part II.C.1.

166. See *supra* notes 53, 116–121 and accompanying text.

167. See *supra* notes 116–121 and accompanying text.

168. See *supra* notes 116–121 and accompanying text.

tionary accounts with fee-based compensation structures and matches non-discretionary accounts with transaction-based compensation structures and (2) imposes a fiduciary duty on discretionary, fee-based accounts and less stringent duties on non-discretionary, transaction-based accounts. The following sections will describe how the United States and the EU could accomplish this alignment and why it would satisfy the concerns of both proponents and opponents of the uniform fiduciary standard.

#### i. Discretion

The United States and the EU have different approaches to discretion. In the United States, the broad trend has been to impose a fiduciary duty on discretionary relationships and a suitability duty on non-discretionary relationships.<sup>169</sup> A problem arose when intermediary category-based regulation led to a breakdown of this distinction, in which broker-dealers could enjoy considerable discretion, yet avoid the fiduciary duty.<sup>170</sup> In the EU, by contrast, the highest level of discretion in the intermediary-investor relationship mandates the suitability standard.<sup>171</sup> A somewhat lower level of discretion gives rise to the appropriateness standard,<sup>172</sup> and no discretion at all removes the conduct of business standard entirely.<sup>173</sup>

The United States and the EU should harmonize their standards by imposing a fiduciary duty on discretionary relationships with retail investors and lesser duties with respect to non-discretionary relationships and non-retail investors. Three reasons militate in favor of such a harmonized standard. First, doing so would not cause a major disruption in either system. The United States already imposes a fiduciary duty on discretionary relationships with retail investors, and the EU's conduct of business obligations, when read together, already come close to imposing such a duty.<sup>174</sup> Second, as uniform fi-

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169. See discussion *supra* Part I.C.

170. See discussion *supra* Part II.B.

171. See discussion *supra* Part I.G. It is important to note that judges in some EU countries have already read fiduciary aspects into the intermediary-investor relationship through MiFID Directive Article 19(1)'s requirement that intermediaries act in the "best interests" of investors. See MiFID 2.0, *supra* note 71, at 136–38.

172. See discussion *supra* Part I.G.

173. Execution-only transactions involving no discretion do not require a suitability or appropriateness determination. See discussion *supra* Part I.G.

174. See *supra* note 171.

duciary proponents have rightly argued, the fiduciary duty is an important form of protection for vulnerable retail investors in trust-based relationships.<sup>175</sup> Third, avoiding a fiduciary duty for non-discretionary relationships and non-retail clients will preserve a meaningful space for legitimate broker-dealer business practices without sacrificing investor protection.<sup>176</sup>

Setting the standard for non-discretionary relationships is more challenging. The United States has generally set the suitability standard as a floor for intermediaries, whereas the EU allows for lesser duties under certain circumstances. The U.S. regime already recognizes, however, that the suitability standard is inappropriate with respect to designated investors;<sup>177</sup> switching to the EU's paradigm of suitability, appropriateness and execution-only would not, therefore, cause a sea change in the type of protection afforded to investors. Although doing so would impose one-time transition costs,<sup>178</sup> the United States should adopt the EU's approach with respect to non-discretionary relationships.

## ii. Compensation Structure

The United States and the EU take different approaches to compensation structure, but neither regime explicitly recognizes that certain compensation structures should give rise to certain duties. In the United States, regulation typically matches the fiduciary duty with fee-based compensation and the suitability duty with transaction-based compensation.<sup>179</sup> However, this was not always the case<sup>180</sup> and would certainly not be the case under the uniform fiduciary duty.<sup>181</sup> The EU, on the other hand, focuses mainly on conflicts of interest disclosure and mitigation but does not prescribe a particu-

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175. See discussion *supra* Part II.B; see also MiFID 2.0, *supra* note 71, at 135–36.

176. See discussion *supra* Part II.C.1.

177. See FINRA, NASD RULE 2310 (1990) (exempting institutional and high-net-worth investors from the suitability standard).

178. Although U.S. firms would incur one-time costs of switching to a customer category-based system, such costs might be offset by a long-term decrease in regulatory costs with respect to non-retail investors.

179. See discussion *supra* Part I.C.

180. Although such situations are relatively rare, some broker-dealers charge fees, and some investment advisers charge commissions. See 913 STUDY, *supra* note 4, at 7–11.

181. Dodd-Frank emphasized that broker-dealers would still be able to use transaction-based compensation structures under a fiduciary duty. See *supra* note 122.



lar compensation structure.<sup>182</sup>

The United States and the EU should recognize that fee-based compensation matches the fiduciary duty and transaction-based compensation does not. Failing to recognize this connection leads to a fundamental mismatch of incentives and duties.<sup>183</sup> By matching incentives and duties, the transatlantic investor regime could ensure that vulnerable investors will be protected while preserving legitimate broker-dealer business practices.<sup>184</sup>

As a result, discretionary relationships should have fee-based compensation, while non-discretionary relationships should have transaction-based compensation. The former would benefit from imposing fiduciary duties while the latter could not. Instead, MiFID's regime of suitability, appropriateness and execution-only transactions should govern non-discretionary, transaction-based relationships. Adopting this harmonized standard would incur one-time costs for both U.S. and EU intermediaries. However, these one-time costs should be more than offset by the long-run benefits of cross-border harmonization.<sup>185</sup>

Harmonization efforts must necessarily focus on intermediaries because they are the main conduit for securities in the secondary market and are best situated to protect investors. A transatlantic investor protection regime would gain additional strength, however, by pursuing further harmonization with respect to issuers and investors. The final subsections will describe how the United States and the EU can take moderate steps to harmonize these obligations.

### *C. Obligations on Issuers*

Although the majority of harmonization must take place with respect to intermediaries, the United States and the EU can improve secondary market regulation by requiring issuers to play a meaningful role in classifying products for particular customer categories. The United States and the EU should move beyond disclosure-based obligations and require issuers to work with intermediaries on classifying products so that intermediaries can make more accurate recommendations with respect to retail and non-retail clients.

Issuers and intermediaries suffer from serious information

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182. See discussion *supra* Part I.G.

183. See *supra* notes 116–121.

184. See discussion *supra* Part I.C.

185. See discussion *supra* Part II.C.2.

asymmetries regarding product risks and characteristics. Intermediaries trade in scores of different products with limited time to read prospectuses or other reports. Issuers, on the other hand, originate financial products and will invariably possess more information about risks and characteristics than the intermediaries who merely trade those products. Yet intermediaries alone must make “best interests,” suitability or appropriateness determinations for investors. Issuers can mitigate these asymmetries at little cost by providing basic information about what kind of investors should typically be able to purchase the products. Although the specific parameters of this obligation are beyond the scope of this Note, imposing some kind of meaningful obligation on issuers should be an essential part of a harmonized transatlantic investor regime.

#### *D. Obligations on Investors*

The EU imposes obligations on investors through its elective professional client regime whereas the United States does not. Investor obligations address the information asymmetry between investors and intermediaries: although investors may need professional guidance, those investors—especially sophisticated investors—still know their own financial situations and objectives better than anyone else. In light of this asymmetry, the United States should adopt MiFID’s elective professional client regime.<sup>186</sup> This would not only harmonize the two regimes but would also maintain protections for retail clients while preserving broker-dealer business practices.

The obligation on investors to initiate re-classification and to provide accurate information is a necessary part of the client classification scheme and must be adopted by the United States in order to achieve meaningful harmonization. Retail clients who want to retain maximum protection would choose not to opt up but would not be able to access certain products or services;<sup>187</sup> experienced retail clients who wish to opt up could gain access to the full menu of services and products that intermediaries can provide, including all services typically provided by broker-dealers.

However, the two regimes should consider plugging a loophole inherent in MiFID’s elective professional client system. Once an elective professional client has been classified as such, MiFID ob-

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186. See discussion *supra* Part I.F.

187. These clients may not be able to access services that are incompatible with the fiduciary duty. See discussion *supra* Part II.C.1.

ligates her to inform the intermediary should she wish to be re-classified, either with respect to a certain product or in general.<sup>188</sup> The intermediary is under no duty to investigate the client's risk appetite or financial situation, even if the investor wishes to obtain products or services that are riskier than those she originally sought as an elective professional client.<sup>189</sup> The two regimes should consider plugging this loophole by imposing a duty to investigate on intermediaries when the investor seeks to participate in a materially different kind of product or service. This adjustment would maintain the flexibility of the elective professional client regime while avoiding situations in which those clients invest in products they do not understand.

## CONCLUSION

The uniform fiduciary standard takes one step forward by decreasing investor confusion and eliminating regulatory arbitrage. At the same time, it takes two steps backward by decreasing harmony with the EU and by threatening legitimate broker-dealer business practices, resulting in decreased liquidity, increased investor costs and decreased investor choice. A harmonized transatlantic investor protection regime could avoid the pitfalls of the uniform fiduciary standard while adding the benefits of cross-border harmonization. This standard should be customer classification-based, aligning fiduciary duties with discretionary, fee-based accounts and less stringent duties with non-discretionary, transaction-based accounts. Finally, the harmonized regime should impose obligations on issuers to provide product classification information to intermediaries and adopt a modified version of MiFID's elective professional client regime. Adopting this harmonized transatlantic protection standard would yield results that everyone could agree upon: more liquidity, increased cross-border investment services competition, decreased investor costs and increased investor choice.

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188. See Kruithof & Van Gerven, *supra* note 70, at 13.

189. *Id.*

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