TESTIMONY OF RON A. RHOADES, JD, CFP®

Before the Employee Benefits Security Administration, U.S. Department of Labor

December 12, 2023 Panel 4 1:30-2:30pm ET

Re: Docket No. EBSA–2023–0014: Hearings, Meetings, Proceedings etc.: Retirement Security Rule; Definition of an Investment Advice Fiduciary and Associated Prohibited Transaction Exemption Amendments

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INTRODUCTION

I am Ron Rhoades, and I serve as Associate Professor of Finance at Western Kentucky University, and I own a registered investment adviser firm, Scholar Financial.[i] Over the past two decades, I have extensively researched, written and spoken about the application of the common law to fiduciary-client relationships in financial services. My testimony does not necessarily represent the views of any institution, firm, or organization, but rather is my own.

REGARDING LIMITS ON CONSUMER CHOICE

First, the argument made by some panelists today that the DOL's rulemaking inappropriately limits "choice" is a *red herring*. By their very nature fiduciary duties imposed by ERISA constrain conduct, and by doing so counter greed.

The U.S. Supreme Court, in the unanimous *Hughes vs. Northwestern* decision, clearly concluded that imprudent investments must be removed from defined contribution plans governed by ERISA.

Stated simply, *bad choices* have no place in retirement plan accounts. Defined contribution plan accounts benefit from economies of scale. And the academic evidence is clear - higher-cost products underperform, on average and over time, similar investments that have lower fees and costs.

Consumer choice is, and should be, limited under ERISA, to only the *good choices*.

RELATIONSHIPS OF TRUST AND CONFIDENCE: THE USE OF TITLES AND DESCRIPTION OF SERVICES

Second, please permit me to address the proposed rule's adherence to the dictates of the 5th Circuit *Chamber of Commerce* opinion. While I do not agree with the 5th Circuit's stretched statutory interpretations in defining "fiduciary"[ii] – given the breadth of ERISA's clear language defining "fiduciary" – I will discuss the applicability of a "special relationship of trust and confidence."

There are many cases under state common law which support the Department's view that the use by securities brokers[iii] or by insurance producers of either *titles* or *descriptions of services offered*, can support the application of fiduciary status.

Court decisions have found that the use of terms such as "financial advisor,"[iv] "financial consultant," "financial planner,"[v] "financial guide,"[vi] "investment counselor,"[vii] "investment planner,"[viii] "estate planner,"[ix] or "expert,"[x] lead to the *justifiable repose* of trust and confidence by a consumer.

The formation of a *retirement plan*[xi] or *investment plan*,[xii] or an *investment policy statement*, or an *estate plan*, can also trigger the application of fiduciary status under common law.[xiii]

Likewise, when there is any representation that ongoing advice will be provided, fiduciary status should attach.[xiv]

I would conclude that words *implying* that fiduciary obligations exist, such as by the giving of "fiduciary warranties," also result in justifiable reliance leading to fiduciary status[xv] in which core fiduciary duties should not be able to be disclaimed.

I suggest that the Department *expressly* extend its proposed rule's application to representations that are made by the firm, not just by an individual broker or insurance agent employed by a firm. Several cases apply common law fiduciary duties in such circumstances.

In conclusion, the use of titles, and the way that financial professionals describe their services today, and by engaging in trust-based and relationship-based sales, all lead to the conclusion that most stockbrokers and insurance producers today have consented to be bound – by these words and representations – to the requirements imposed by fiduciary status.

In fact, the SEC, in its 1940 Annual Report, noted that a broker should not "disguise" himself or herself as a "confident and protector" but rather "must stand at arms length ... openly as an adversary."[xvi] Hence, I would *personally* go further. When a stockbroker or insurance agent provides investment or annuity recommendations and states to the customer, either verbally, or in any written document, including Form CRS, that he or she is acting in the "best interests" of the customer, I would opine that justifiable reliance by the customer likely exists, and fiduciary status should attach. To provide recommendations under the mantra of acting in a customer's "best interests" – a phrase which over 10,000 judicial decisions in the United States have applied as equivalent to the fiduciary duty of loyalty – but then for that person or firm to disavow fiduciary status – is tantamount to actual fraud. But I suspect that the Department of Labor will not seek to fix, at least with respect to ERISA Title I and II plans, the mess that both the SEC and NAIC have created recently with their "best interests" rulemakings.

RELATIONSHIPS OF TRUST AND CONFIDENCE: SALESPEOPLE HAVE HISTORICALLY BEEN FIDUCIARIES WHEN JUSTIFIABLE RELIANCE EXISTS

Some commentators on the DOL's proposal have opined that salespeople – registered representatives and insurance producers – are "historically distinct" from fiduciaries. Yet, legal history states otherwise. In addition to the cases I have cited in XXXx regarding the use of titles, many instances occur in which financial product sellers are regarded as fiduciaries:

- In fact, by the early 1930's, the fiduciary duties of brokers were already widely known under state common law.[xvii]
- Judicial decisions from 1934[xviii] and 1935[xix] applied fiduciary status upon brokers where a relationship of trust and confidence existed, applying state common law.
- While the vision has not yet been fulfilled, the 1934 Exchange Act was intended, by President Franklin Roosevelt, to impose fiduciary duties upon brokers.[xx]
- The Securities Markets Study of 1935 recognized that a broker "exercises, to some extent, the function of an investment counsel" and recommended that conflicts of interest be minimized.[xxi]
- It has been long been known that the common law of agency clearly applied fiduciary duties to the provision of investment advice.[xxii]

- Shortly after its formation, even FINRA (formerly NASD) unequivocally announced that brokers were fiduciaries to their customers.[xxiii]
- In the 1940[xxiv] and 1942 SEC Annual Reports, the SEC discussed at length a series of cases in which brokers were found to be fiduciaries, and the SEC also noted that "the very function of furnishing investment counsel constitutes a fiduciary function."[xxv]
- The 1940 Advisers Act, while providing an exemption from the application of the Advisers Act to broker-dealers in certain circumstances, did not overturn state common law principles. Brokers may have been exempted under the Advisers Act from *registration* as investment advisers; but this exemption did not negate the fiduciary status of brokers when they developed relationships of trust and confidence with their clients.
- In the well-known 1948 *Arleen Hughes* opinion, the SEC found that a broker-dealer was a fiduciary where she created a relationship of trust and confidence with her customers.[xxvi]
- In 1963 the SEC Study also noted that brokers in relationships of trust and confidence with their customers were fiduciaries, and the Study cautioned that brokers should not obscure the merchandising aspects of the retail securities business.[xxvii]

IRA ROLLOVERS ARE FIDUCIARY ACTS

It should also be noted that the U.S. Supreme Court has previously opined on ERISA that, "[a]t common law, fiduciary duties characteristically attach to decisions about managing assets and *distributing property to beneficiaries*."[xxviii] The decision to distribute ERISA plan assets to a beneficiary, via an IRA rollover, clearly falls within that ambit. Even a one-time rendering of advice, such as the rollover of an ERISA plan account or IRA account into an immediate fixed annuity – a decision of huge financial consequences – can be, and should be, subject to fiduciary duties.[xxix]

INVESTMENT ADVICE TRIGGERS FIDUCIARY STATUS

Lastly, some commentors may opine that fiduciary duties don't apply to just "advice" and rather only apply to where a fiduciary controls or manages assets. Yet such a statement is *blindly* incorrect. There has long been recognition that the mere provision of advice may result in a fiduciary relationship.[xxx]

I have chosen to submit written remarks on other issues present.

Thank you.

Respectfully submitted,

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ADDITIONAL WRITTEN COMMENTS

Since time does not permit me to include these as part of my verbal testimony, please accept the following as written comments on the proposed regulation.

THE DEPARTMENT'S INTERPRETATION OF FIDUCIARY IS BOTH IN LINE WITH ITS AUTHORITY AND REASONABLE, AND THE INTERPRETATION REFLECTS THE CHANGES IN THE CAPITAL MARKETS AND THE FUNCTIONS OF STOCKBROKERS AND INSURANCE AGENTS SINCE 1975.

The Department possesses the authority to undertake this proposed rule and has acted reasonably in doing so.

As a District Court decision this year noted, Congress granted the Department broad authority to issue technical terms relating to fiduciary status[xxxi] for both ERISA-governed plans and IRAs.[xxxii] The Department has, in accordance with the 5th Circuit's ruling to tie fiduciary status to relationships of trust and confidence, appropriately taken "actions that fall within the broad grant of Congressional authorization."[xxxiii]

Since 1975, both registered representatives and insurance producers have broadened the scope of the advice they provide. Over the decades new products have been created, often of a pooled and complicated nature. Gone are the days where most stockbrokers were primarily engaged in the execution of individual securities trades. And gone are the days when annuities were relatively straightforward products. And, over the years, both registered representatives and insurance agents have been trained in relationship-based selling, as well as trust-based selling. It should come as no surprise that, by broadening the scope of their services and advice, and seeking to have customers believe they can be trusted, that it is far easier today than it was in 1940 to conclude that a registered representative or an insurance producer is in a relationship of trust and confidence with a customer. As stated more recently by law professor Thomas Lee Hazen: "Notwithstanding the absence of an explicit fiduciary standard, broker-dealers are subject to substantially similar requirements when they act as more than mere order takers for their customers' transactions."[xxxiv]

This is true because, as the capital markets (and various investment and annuity products) have increased in complexity, greater asymmetry in information and skill takes place. Indeed, for a "confidential relation" to occur under the law, there is typically the placement of trust by one person in another, often the result of asymmetric information or disparate skill. One court described the situation in which parties deal with each other from substantially different positions, resulting in the possibility of abuse of the superior position:

> Confidential relation is not confined to any specific association of the parties; it is one wherein a party is bound to act for the benefit of another, and can take no advantage to himself. It appears when the circumstances make it certain the parties do not deal on equal terms, but, on the one side, there is an overmastering influence, or, on the other, weakness, dependence, or trust, justifiably reposed; in both an unfair advantage is possible.[xxxv]

CONFLICTS OF INTEREST SHOULD BE MINIMIZED IN DECISIONS INVOLVING WHETHER TO PURCHASE AN ANNUITY; ANNUITIZATION INVOLVES FINANCIAL PLANNING

In recent years a major development has occurred with respect to annuities ... more and more insurance companies are offering annuity products *with no commissions*. These products can deliver more of the returns of the capital markets to the consumer.

The DOL should encourage plan sponsors to realize that the decision to annuitize a portion of a retiree's nest egg is not merely the choice of an annuity product but is rather a key lifetime financial planning decision. Considerations before annuitization involve health / genetics / estimated longevity of the retiree (and spouse), the presence of debt, both present and future cash flow needs, the interplay with the participant's (and spouse's) strategy to maximize the utility of Social Security retirement benefits and/or pension benefits, the desire or need of the retiree (or couple) to provide support to other family members (including by means of inheritance), the presence of other assets or resources, the risk tolerance and capacity of the client, the current interest rate environment, whether inflation adjustments occur over time with annuitization, and the current expected returns of various asset classes given valuation levels in the capital markets. Even when annuitization, following this complex financial planning process, is to be undertaken, annuities should be competitively shopped, as payout rates change frequently among insurers. Strong consideration should be given to the financial strength of the insurer and the presence (and limitations of) state guaranty programs.

Moreover, given the emergence of immediate annuities with no commissions, the DOL should encourage plan sponsors to entertain proposals from fiduciary (trusted, expert) and completely independent financial advisors (even going so far as to exclude those who manage investment portfolios for a fee) for flat or fixed fee engagements for the annuitization analysis. Should annuitization be undertaken, such independent fiduciary advisers should be charged with the conduct of proper due diligence in the current marketplace to obtain the best possible annuitization solution(s) for the plan participant. To avoid conflicts, payment for such flat fee(s) for the annuitization analysis, and the subsequent choice of annuity(ies), should be paid from the defined contribution account, with the fiduciary adviser not receiving any third-party compensation.

THE DOL SHOULD ENCOURAGE ALL PLAN SPONSORS TO HIRE ONLY FINANCIAL ADVISORS WHO ESCHEW PRODUCT-RELATED COMPENSATION

It is possible that commission-based compensation be eliminated. Every commission can be transformed into a clearly understandable fixed fee that would be paid directly by the consumer. There is no need today for product-based compensation, and the conflicts of interest posed thereby. Every commission or 12b-1 fees could easily be converted to a fixed fee or an ongoing asset-based fee.

Why should commissions be eliminated? Time and again our courts have enumerated the fiduciary maxim: "No man can serve two masters." An early decision stated: "It is well settled as a general principle, that trustees, agents, auctioneers, and all persons acting in a confidential character, are disqualified from purchasing. The characters of buyer and seller are incompatible, and cannot safely be exercised by the same person. *Emptor emit quam minimo potest; venditor vendit quam maximo potest*. The disqualification rests, as was strongly observed in the case of the *York Buildings Company v. M'Kenzie*, 8 Bro. Parl. Cas. 63, on no other than that principle which dictates that a person cannot be both judge and party. No man can serve two masters. He that it interested with the interests of others, cannot be allowed to make the business an object of interest to himself; for, the frailty of our nature is

such, that the power will too readily beget the inclination to serve our own interests at the expense of those who have trusted us."[xxxvi]

FIXED INDEX ANNUITIES NEED TO IMPROVE; VARIABLE ANNUITIES FAIL THE COST-BENEFIT ANALYSIS

While the theory behind the investment strategy underlying fixed index annuities has some academic support, the implementation of that strategy by insurance companies is heavily flawed. I suggest that non-commissioned fixed index annuities, with no surrender fees and with other structural changes that limit the compensation received by insurance companies, could be developed that would serve a useful purpose in retirement portfolios. It should be noted that there exist some ETF products that, at far lower cost, provide similar benefits to investors.

I further suggest that variable annuities only "win" when the variable annuity product's investments miserably fail over short periods of time. Over long periods of time high-cost, high-fee variable annuities with "downside protection" and "guarantees" upon annuitization nearly always are poor investment solutions. Given the availability of other investment and annuity strategies to limit downside risk there is little justification for the use of variable annuities in defined contribution plans (or elsewhere). I have searched long and hard, yet I have never found a legitimate use for variable annuity products, at least for 99% or more of consumers.

THE DOL SHOULD INFORM PLAN SPONSORS TO ALWAYS ENGAGE FIDUCIARIES WHEN RECEIVING RECOMMENDATIONS ON INVESTMENTS OR ANNUITIES

Plan sponsors, who are fiduciaries, should be cautioned to always engage only fiduciaries as investment consultants who proactively eschew conflicts of interest. A true fiduciary avoids revenue-sharing payments and other third-party compensation that create nefarious conflicts of interest, in recognition of the fact, as many a jurist has opined, that a fiduciary cannot serve two masters.

Moreover, it is important that, should a breach of fiduciary duties occur, that the financial advisor providing the investment recommendations be held to account. Otherwise, large and small business owners – who are not experts in investment due diligence – are often left holding the bag.

THE DOL SHOULD CAUTION PROVIDERS TO TAX-EFFICIENTLY MANAGE PARTICIPANT'S ACCOUNTS.

The DOL should encourage providers of investment solutions to defined contribution plans where both "traditional" and "Roth" options exist to develop and implement tax-efficient asset placement, so as to adhere to the prudent investor rule's often-overlooked requirement to minimize the tax drag upon investment returns. The DOL should encourage providers to address this often-overlooked requirement of the prudent investor rule through software and other solutions that undertake tax-efficient asset placement, and through plan participant education (although such education is largely ineffective, as to most plan participants, without additional services being provided by some means).

THE DOL SHOULD CAUTION PLAN SPONSORS TO ENSURE ADEQUATE ASSET CLASS DIVERSIFICATION, INCLUDING THE APPLICATION OF ACADEMIC RESEARCH IN DETERMINING WHICH ASSET CLASSES TO INCLUDE

I further suggest that the decades-long movement to limit the number of funds in any defined contribution plan to 20, or even 30, is based on outdated research, given the rise of target date funds as well as developments in modern academic research into investment strategies and better discernment of the risks and potential range of returns for various asset classes. I further suggest that most ERISA-governed defined contribution plans fail to adequately diversify among asset classes by not including low-cost multi-factor funds (based upon sound academic evidence) in U.S., foreign developed, and foreign emerging markets, and/or by excluding other asset classes which can enhance investors' portfolios. The arbitrarily imposed limits on the number of funds within defined contribution plans pose a potential violation of the prudent investor rule, and the plan sponsor's duty of care, generally. I encourage plan sponsors, and the DOL using its survey and information-gathering capabilities, to re-visit the requirement of diversification among asset classes in order to ensure that asset classes worthwhile of inclusion into plan lineups not be excluded, in order that plan participants (and their investment advisors) are afforded the opportunities to maximize the expected returns, and/or seek steps to minimize risks, through properly diversified portfolios applying evidence-based investment techniques.

Respectfully submitted,

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Principal and Financial Advisor, Scholar Financial, LLC, a registered investment adviser, and I have served previously with other RIA firms both large and small. In addition, I have undertaken various consulting engagements over the years with broker-dealer firms, insurance companies, and RIA firms. In addition, I frequently visit financial services firms with my students.

[ii] "The ERISA definition of fiduciary is broad, extending well beyond the concept of trustee in trust law and generally further than the scope of individuals who owe fiduciary duties to third parties under the common law. Both ERISA (Title I) and the Internal Revenue Code (Title II) define 'fiduciary' in the same way. In Title I, fiduciaries are subject to comprehensive DOL regulation, while in Title II individual plans, they are subject to the prohibited transactions provisions." West's Key Number Digest, Labor and Employment, 461.

The 5th Circuit opined on "one out of three provisions explaining the scope of fiduciary responsibility under ERISA and the Internal Revenue Code. The second of these three provisions states that 'a person is a fiduciary with respect to a plan to the extent . . . he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so[.]'" In my view, Congress supplied the scope of the application of fiduciary duties by clear, unambiguous language; Congress could have but did not require that a "special relationship of trust and confidence" existed. Congress, through its multiple-prong test for applicability of

fiduciary duties under ERISA, provided the "other indication" which the 5th Circuit ignored. The 5th Circuit appeared to conflate the scope of application of fiduciary duties with the need to look to the law of trusts to determine the "contours of an ERISA fiduciary's duty." The 5th Circuit cited these cases, incorrectly:

1) *Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan*, 555 U.S. 285, 294–96 (2009) involves not *whether* ERISA fiduciary duties applied to the situation presented in the case, but rather the interpretation of the *how* fiduciary duties are applied, specifically the anti-assignment provision of ERISA. Justice Souter stated that "the law of trusts .... serves as ERISA's backdrop" – citing *Beck v. PACE Int'l Union*, 551 U. S. 96, 101 (2007), a case which required the Court to "delve into the statutes provisions for plan termination" – again, the interpretation of how fiduciary duties are applied (in this instance, the construction of the statutory language involving how ERISA plans are terminated).

2) *Aetna Health Inc. v. Davila*, 542 U.S. 200, 218–19 (2004) is more relevant. Justice Scalia wrote: "At common law, fiduciary duties characteristically attach to decisions about managing assets and distributing property to beneficiaries. *Pegram, supra*, at 231; *cf*. 2A A. Scott & W. Fratcher, Law of Trusts §§182, 183 (4th ed. 1987); G. Bogert & G. Bogert, Law of Trusts & Trustees §541 (rev. 2d ed. 1993). Hence, a benefit determination is part and parcel of the ordinary fiduciary responsibilities connected to the administration of a plan. *See Varity Corp. v. Howe*, 516 U. S. 489, 512 (1996) (relevant plan fiduciaries owe a fiduciary duty with respect to the interpretation of plan documents and the payment of claims)." (Emphasis added.)

3) *Pegram v. Herdrich*, 530 U.S. 211, 223–24 (2000), which addressed not whether ERISA applied, but rather *how* fiduciary duties were applied under ERISA, with Justice Souter stating:

   > In general terms, fiduciary responsibility under ERISA is simply stated. The statute provides that fiduciaries shall discharge their duties with respect to a plan "solely in the interest of the participants and beneficiaries," §1104(a)(1), that is, "for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan," §1104(a)(1)(A). These responsibilities imposed by ERISA have the familiar ring of their source in the common law of trusts. *See Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc*., 472 U. S. 559, 570 (1985) ('[R]ather than explicitly enumerating all of the powers and duties of trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility'). Thus, the common law (understood as including what were once the distinct rules of equity) charges fiduciaries with a duty of loyalty to guarantee beneficiaries' interests: 'The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty.... It is the duty of a trustee to administer the trust solely in the interest of the beneficiaries.' 2A A. Scott & W. Fratcher, Trusts §170, 311 (4th ed. 1987) (hereinafter Scott); *see also* G. Bogert & G. Bogert, Law of Trusts and Trustees §543 (rev. 2d ed. 1980) ("Perhaps the most fundamental duty of a trustee is that he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary and must exclude all selfish interest and all consideration of the interests of third persons"); *Central States, supra*, at 570–571; *Meinhard v. Salmon*, 249 N. Y. 458, 464, 164 N. E. 545, 546 (1928) (Cardozo, J.) ("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 is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior").

4) *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989), which again addressed *how* ERISA applied its fiduciary duties, rather than *whether* ERISA applied to the situation at hand, with the Court stating:

> ERISA abounds with the language and terminology of trust law. See, e. g., 29 U. S. C. §§ 1002(7) ("participant"), 1002(8) ("beneficiary"), 1002(21)(A) ("fiduciary"), 1103(a) ("trustee"), 1104 ("fiduciary duties"). ERISA's legislative history confirms that the Act's fiduciary responsibility provisions, 29 U. S. C. §§ 1101-1114, "codif[y] and mak[e] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts." H. R. Rep. No. 93-533, p. 11 (1973). Given this language and history, we have held that courts are to develop a "federal common law of rights and obligations under ERISA-regulated plans." *Pilot Life Ins. Co. v. Dedeaux, supra*, at 56. *See also Franchise Tax Board v. Construction Laborers Vacation Trust*, 463 U. S. 1, 24, n. 26 (1983) (" '[A] body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans'") (quoting 129 Cong. Rec. 29942 (1974) (remarks of Sen. Javits)). In determining the appropriate standard of review for actions under § 1132(a)(1)(B), we are guided by principles of trust law. *Central States, Southeast and Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U. S. 559, 570 (1985).

[iii] The application of fiduciary standards of conduct to the personalized investment advisory activities of brokers is nothing new. It preceded the enactment of the Securities Exchange Act of 1934 and continued thereafter. Moreover, the Investment Advisers Act of 1940 never stated that brokers were *not* fiduciaries; it only provided an exemption from registration as an investment adviser.

[iv] "In the fall of 1985, plaintiff, having recently divorced and relocated to Columbus, Ohio, sought investment advice from Thomas J. Rosser. At the time, Rosser was a licensed salesman for Great Lakes Securities Company and **held himself out as a financial advisor** ... [T]he evidence established that Rosser was a licensed **stockbroker** and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship." *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002). The court further noted, that under Ohio law, a fiduciary relationship is "a relationship in which one party to the relationship places a special confidence and trust in the integrity and fidelity of the other party to the relationship, and there is a resulting position of superiority or influence, acquired by virtue of the special trust." *Id.*

In another judicial decision, a dual registrant crossed the line in **"holding out" as a financial advisor**, and in stating that ongoing advice would be provided, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

[v] A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, "The developer defendants obtained investment capital from the public by **posing as financial planners ... The financial planners typically had a background in either insurance or real estate sales** ... As an alleged financial planning company, CSCC, dba

Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation... CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled ... At the seminars, CSCC offered to draft a 'Coordinated Financial Plan' for attendees at little or no charge. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project ...." The court also noted, "Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status."

[vi] "We are persuaded from the facts of the case that a trust relationship existed between the parties ... The **[broker]** argues that he was not a trustee but a broker only. This argument finds little to support it in the testimony. **He assumed the role of financial guide and the law imposed upon him the duty to deal fairly with the complainant even to the point of subordinating his own interest to hers.** This he did not do. He risked the money she entrusted to him in making a market for hazardous securities. He failed to inform her of material facts affecting her interest regarding the securities purchased. He consciously violated his agreement to maintain her income, and all the while profited personally at the complainant's expense. Even as agent he could not gain advantage for himself to the detriment of his principal." *Norris v. Beyer,* 124 N.J. Eq. 284; 1 A.2d 460 (1938).

[vii] **Insurance agents** who introduced themselves as "**investment counselors or enrollers**" and who tailored retirement plans for each person depending on the individual's financial position, and who led the customers to believe that an **investment plan** was being drafted for each customer according to each customer's needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).

[viii] When a bank held out as either an "investment planner," "financial planner," or "financial advisor," the Wisconsin Supreme Court held that a fiduciary duty may arise in such circumstances. *Hatleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005).

[ix] In a case arising from Oregon, a self-employed **insurance seller and licensed financial planner** took advantage of his position as a financial advisor to gain the trust of an 87-year-old man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about $400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a **financial advisor and estate planner**. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006).

[x] This may be particularly true where the **broker holds himself out as an expert** in a field in which the customer is unsophisticated. *See, e.g., Burdett v. Miller, 957 F.2d 1375* (7th Cir. 1992); *Paine, Webber, Jackson & Curtis, Inc. v. Adams*, supra at 517, *citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Boeck*, 127 Wis. 2d 127, 145-146, 377 N.W.2d 605 (1985) (Abrahamson, J., concurring) ("By gaining the trust of a relatively uninformed customer and purporting to advise that person and to act on that person's behalf, a broker accepts greater responsibility to that customer").

[xi] *See, e.g., Hanick v. Ferrar*, 161 N.E. 3rd 1 (Ohio 7th Dist. Ct. of Appeals (2020) ("Ferrara also disclosed at deposition that he lectured Appellant about spending money on her friend. He even told her that if she continued to run through her money in this manner he could no longer 'in good faith' be her agent, suggesting he occupied a position akin to a financial adviser ... There was a genuine issue of material fact as to the existence of a fiduciary relationship.")

[xii] **Insurance agents** who introduced themselves as "investment counselors or enrollers" and who tailored retirement plans for each person depending on the individual's financial position, and who led the customers to believe that an **investment plan** was being drafted for each customer according to each customer's needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).

[xiii] In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, "The developer defendants obtained investment capital from the public by **posing as financial planners** ... The financial planners typically had a **background in either insurance or real estate sales** ... As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation... CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled ... **At the seminars, CSCC offered to draft a 'Coordinated Financial Plan' for attendees at little or no charge**. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project ...." The court also noted, "Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status."

[xiv] A dual registrant crossed the line in **"holding out" as a financial advisor**, and in **stating that ongoing advice would be provided**, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

[xv] "The relationship between a customer and the financial practitioner should govern the nature of their mutual ethical obligations. Where the fundamental nature of the relationship is one in which customer **depends on the practitioner to craft solutions for the customer's financial problems**, the ethical standard should be a fiduciary one that the advice is in the best interest of the customer. To do otherwise – **to give biased advice with the aura of advice in the customer's best interest** – is fraud. This standard should apply regardless of whether the advice givers call themselves advisors, advisers, brokers, consultants, managers or planners." James J. Angel, Ph.D., CFA and Douglas McCabe Ph.D., "Ethical Standards for Stockbrokers: Fiduciary or Suitability?" (Sept. 30, 2010). Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1686756.

[xvi] In its 1940 Annual Report, the U.S. Securities and Exchange Commission noted: "If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject' to 'fiduciary duty. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States. Court of Appeals for the District of Columbia in a recently decided case: '[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who would deal at arm's length must stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and

protector. He cannot commingle his trusteeship with merchandizing on his own account...'" *Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941*, at p. 158, citing *Earll v. Picken* (1940) 113 F. 2d 150.

[xvii] By the early 1930's, the fiduciary duties of brokers (as opposed to dealers[xvii]) were widely known. As summarized by Cheryl Goss Weiss, in contrasting the duties of an broker vis-à-vis a dealer:

> By the early twentieth century, the body of common law governing brokers as agents was well developed. *The broker, acting as an agent, was held to a fiduciary standard* and was prohibited from self-dealing, acting for conflicting interests, bucketing orders, trading against customer orders, obtaining secret profits, and hypothecating customers' securities in excessive amounts -- all familiar concepts under modern securities law. Under common law, however, a broker acting as principal for his own account, such as a dealer or other vendor, was by definition not an agent and owed no fiduciary duty to the customer. The parties, acting principal to principal as buyer and seller, were regarded as being in an adverse contractual relationship in which agency principles did not apply.

Cheryl Goss Weiss, *A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty*, 23 J. CORP. L. 65, 66 (1997) (providing a summary of the historical development of brokers and dealers before the '33 and '34 securities acts).

[xviii] In the 1934 case of *Birch v. Arnold*, in a case which did not appear to involve the exercise of discretion by a broker, the relationship between a client and her stockbroker was found to be a fiduciary relationship, as it was one of trust and confidence. As the court stated:

> She had great confidence in his honesty, business ability, skill and experience in investments, and his general business capacity; that she trusted him; that he had influence with her in advising her as to investments; that she was ignorant of the commercial value of the securities he talked to her about; and that she had come to believe that he was very friendly with her and interested in helping her. He expected and invited her to have absolute confidence in him, and gave her to understand that she might safely apply to him for advice and counsel as to investments ... She unquestionably had it in her power to give orders to the defendants which the defendants would have had to obey. In fact, however, **every investment and every sale she made was made by her in reliance on the statements and advice of Arnold** and she really exercised no independent judgment whatever. She relied wholly on him. [**Emphasis added.**]

Birch v. Arnold, 88 Mass. 125; 192 N.E. 591; 1934 Mass. LEXIS 1249 (Mass. 1934).

[xix] In the instant case the plaintiff was a layman, and was not fully acquainted with all the technicalities of the street or dealings on the exchange. She had a right to assume that the relationship of customer and broker, a fiduciary, would protect her, to the end that in acting for her, they would do all in their power to protect her account with them, and that in so doing she would get the full advantage of the knowledge of the defendants as such brokers in the management and care of the account. This she had a right to assume, and this she was entitled to ... The law is well settled that the fiduciary relationship between the customer and broker requires full faith and confidence be given to the acts of the brokers in the belief that they would at all times be acting for their customer in all his dealings, and the plaintiff had a right to assume and to rely upon the fact that they were acting for her benefit at all times during the existence of such relationship." *Johnson v. Winslow*, Supreme Court of New York, New York County, 155 Misc. 170; 279 N.Y.S. 147 (1935).

[xx] "Roosevelt and Congress used the 1934 Exchange Act to raise the standard of professional conduct in the securities industry from the standardless principle of caveat emptor to a 'clearer understanding of the ancient truth' that brokers managing 'other people's money' should be subject to professional trustee duties."

Matthew P. Allen, A Lesson from History, Roosevelt to Obama - The Evolution of Broker-Dealer Regulation: From Self-Regulation, Arbitration, and Suitability to Federal Regulation, Litigation, and Fiduciary Duty, Entrepreneurial Bus. Law. J. (2010), at p. 20, *citing* Steven A. Ramirez, The Professional Obligations of Securities Brokers Under Federal Law: An Antidote for Bubbles?, 70 U. Cin. L. Rev. 527 (2002), at p. 534 (*quoting* H.R. Rep. No. 73-85, at 1-2 (1933)).

[xxi] *The Securities Markets* study, in fact, recognized that a broker "exercises, to some extent, the function of an investment counsel" and recommended that "a condition should be created where the conflict of interest between broker and customer is reduced to a minimum."

In essence, the Securities Market study recommended that brokers be held to the "best interests" fiduciary standard of conduct, with conflicts of interest minimized. Also, the study recommended the separation of brokers and dealers (who deal in their own securities, or who sell offerings of securities firms in initial or subsequent public offerings).

The Securities Market study also, in essence, recommended that investment counsel be held to the "sole interests" fiduciary standard in which avoidance of all conflicts of interest was required. Additionally, no "dual registration" (as exists today) as both a broker (or dealer) and investment adviser ("investment counsel" in 1935) would be permitted, given the insidious conflicts of interest under such affiliations.

[xxii] The fact that stockbrokers were known to be fiduciaries at an early time in the history of the securities industry (when acting as brokers and not acting as dealers) should not come as a surprise. To a degree it is simply an extension of the laws of agency. One might then surmise that, if the broker provides personalized investment advice, then a logical extension of the principles of agency dictates that the fiduciary duties of the agent also extend to those advisory functions, as the scope of the agency has been thus expanded. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. e (2006) ("Any agent has power over the principal's interests to a greater or lesser degree. This determines the scope in which fiduciary duty operates.").

[xxiii] In an opinion issued by this self-regulatory organization for broker-dealers, in only its second newsletter to members, the NASD unequivocally pronounced that brokers were fiduciaries: "Essentially, a broker or agent is a fiduciary and he thus stands in a position of trust and confidence with respect to his customer or principal. He must at all times, therefore, think and act as a fiduciary. He owest his customer or principal complete obedience, complete loyalty, and the exercise of his unbiased interest. The law will not permit a broker or agent to put himself in a position where he can be influenced by any considerations other than those to the best interests of his customer or principal ... A broker may not in any way, nor in any amount, make a secret profit ... his commission, if any, for services rendered ... under the Rules of the Association must be a fair commission under all the relevant circumstances." *The Bulletin*, published by the National Association of Securities Dealers, Volume I, Number 2 (June 22, 1940).

[xxiv] "In some of these cases, including *Commonwealth Securities, Inc.* and *Securities Distributors Corporation*, the registered broker or dealer had attempted to avoid fiduciary responsibility by use of words on the confirmation intend to indicate that in the particular transaction it had not acted in a fiduciary capacity, but, in such cases, the Commission held that the form of confirmation could not alter the fiduciary character of the relationship where this was clearly established from the other facts and circumstances surrounding the transaction." *Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941*, at p. 158.

[xxv] *1942 SEC Annual Report*, p. 15, referring to *In the Matter of Willlam J. Stelmack Corporation*, Securities Exchange Act Releases 2992 and 3254.

[xxvi] *Arleen W. Hughes*, Exch. Act Rel. No. 4048, 27 S.E.C. 629 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949) (broker-dealer is fiduciary where she created relationship of trust and confidence with her customers);

[xxvii] The SEC also "has held that where a relationship of trust and confidence has been developed between a broker-dealer and his customer so that the customer relies on his advice, a fiduciary relationship exists, imposing a particular duty to act in the customer's best interests and to disclose any interest the broker-dealer may have in transactions he effects for his customer ... [BD advertising] may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business ... Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties." 1963 SEC Study, citing various SEC Releases.

The SEC has also opined: "[T]he merchandising emphasis of the securities business in general, and its system of compensation in particular, frequently impose a severe strain on the legal and ethical restraints." 1963 SEC Study.

[xxviii] *Aetna Health Inc. v. Davila*, 542 U.S. 200, 231 (2004).

[xxix] Federation of Americans for Consumer Choice, Inc. vs. DOL, 2023 WL 5682411, U.S.D.C. N.D. Texas (June 30, 2023), stating: "[A]s another court has noted, '[n]othing in the phrase 'renders investment advice' suggests that the statute applies only to advice provided 'on a regular basis.' ' *Nat'l Ass'n for Fixed Annuities v. Perez,* 217 F. Supp. 3d 1, 23 (D.D.C. 2016). Indeed, ERISA expressly authorizes the DOL to impose fiduciary duties on those who provide recommendations concerning Title I assets, if that investment advice is given 'for a fee or other compensation.' While a regular, ongoing relationship may be indicative of one based in confidence and trust, the length of the relationship itself is not dispositive of whether the recommendation is investment advice ... First-time advice may be sufficient to confer fiduciary status and is consistent with ERISA ... ERISA does not include a regular basis requirement."

[xxx] As Professor Laby notes, "Historically, providing advice has given rise to a fiduciary duty owed to the recipient of the advice. Both the *Restatement (First)* and *Restatement (Second) of Torts* state, "[a] fiduciary relation exists between two persons when one of them is under a duty to act for *or to give advice* for the benefit of another upon matters within the scope of the relation" [citing RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1979) (citation omitted) (emphasis added); RESTATEMENT (FIRST) OF TORTS § 874 cmt. a (1939) (citation omitted) (*emphasis added*)]. Arthur C. Laby, *Fiduciary Obligation of Broker-Dealers and Investment Advisers*, 55 Vill.L.R. 701, 714 (2010). *See also, e.g.*, RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1979) ("A fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." citing Restatement, Second, Trusts § 2).

[xxxi] Federation of Americans for Consumer Choice, Inc. vs. DOL, 2023 WL 5682411, U.S.D.C. N.D. Texas (June 30, 2023), citing ERISA § 505, 29 U.S.C. § 1135; ERISA § 2(a), 29 U.S.C. § 1001(a).

[xxxii] *Id.*, stating: "Since ERISA's enactment, the DOL has been expressly granted the authority to issue PTEs for Title I plans; and, in 1984, the President and Congress granted the DOL the ability to issue PTEs for Title II plans. 29 U.S.C. § 1135; Act of Oct. 19, 1984, Pub. L. No. 98-532, § 1, 98 Stat. 2705, 2705. The DOL also has express authority to publish exemptions for Titles I and II and to define "accounting, technical and trade terms" used in ERISA. 29 U.S.C. § 1135. With its expertise in defining those terms and standards outlining fiduciary status regarding ERISA plans, the DOL is well-suited to address issues relating to defining certain characteristics of fiduciary status." *Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941*, at p. 158, citing *Earll v. Picken* (1940) 113 F. 2d 150.

[xxxiii] *Id.*

[xxxiv] Hazen, Thomas Lee, Stock Broker Fiduciary Duties and the Impact of the Dodd-Frank Act. North Carolina Banking Institute, Vol. 15, 2011; UNC Legal Studies Research Paper No. 1767564. Available at SSRN: http://ssrn.com/abstract=1767564.

[xxxv] *Leedom* v. *Palmer,* 274 Pa. 22, 117 A. 410, 411.

[xxxvi] *Carter v. Harris*, 25 Va. 199, 204; 1826 Va. LEXIS 26; 4 Rand. 199 (Va. 826).