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FINRA Rules Could Create a De Facto 'Uniform' Fiduciary Standard

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In January 2011, the SEC, under the mandate dictated by the Dodd-Frank Act, announced its recommendation that there be a uniform fiduciary duty standard applied to both broker-dealers and registered representatives. The Securities and Exchange Commission has stated that it would propose that uniform fiduciary duty standard by July 2011. That promulgation date has since been delayed again. If the recent comments of Barney Frank, one of the namesakes of Dodd-Frank, questioning whether broker-dealers should be subject to the same fiduciary duty as are registered investments advisers, are an indication, it is unlikely there will be any "uniform" fiduciary duty in the near term.

Nevertheless, the Financial Industry Regulatory Authority has, since the passage of Dodd-Frank, taken steps toward further regulating broker-dealers and is likely to promulgate new rules that may make a uniform duty unnecessary because, through rulemaking, FINRA may impose additional obligations on member firms that would otherwise be consistent with a uniform fiduciary duty standard.

For example, on July 1, 2011, FINRA Rule 4530 came into effect. This rule represents a combination of FINRA Rule 3070 and NYSE Rule 351, requiring member firms to self-report a number of categories of information. The most aggressive and controversial component of this rule is the requirement that a member firm self-report within thirty days after it concluded or reasonably should have concluded that an associated person or the firm violated any securities, insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct. The interpretive comments to Rule 4530 provide that a firm should report where the conduct has widespread, or potential widespread, ramifications that stem from the material failure of the firm's systems, policies or practices involving numerous clients, multiple errors or significant dollar amounts.

In the end, all member firms will be forced to report conduct that they would have likely never reported in the past. This will surely increase supervision of registered representatives by member firms and, in turn, require registered representatives to exercise greater care toward their clients.

Similarly, FINRA Rule 2090 goes into effect in July 2012. Rule 2090 is the new "know your customer" rule, effectively replacing NYSE Rule 405 and FINRA Rule 2310. This rule requires every member to use reasonable diligence in regard to the opening and maintenance of every account, to know (and retain) essential facts concerning every customer and concerning the authority of each person to act on behalf of the customer.

The comments to this rule explain that facts essential to knowing the customer are those required to (1) effectively service the account; (2) act in accordance with any special handling instructions on the account; (3) understand the authority of each person acting on behalf of the customer; and (4) comply with the applicable laws regulations and rules.

Although this rule is not the same as the fiduciary duty obligations of a registered investment adviser, it certainly broadens the obligations of a member firm and its registered representatives to exercise additional care toward their clients. In essence, this rule can be seen as a fallback in the event that there is no uniform fiduciary duty.

Despite the fact that there is ever increasing uncertainty regarding the adoption of a uniform fiduciary duty standard, Rules 4530 and 2090 reflect that FINRA does not intend to stand idle in its regulation of broker-dealers and their registered representatives. If anything, the promulgation of these rules only reflects a growing trend for further regulation. In the end, these and other sure-to-come rules may make the existence of a uniform fiduciary duty standard a matter of form over substance.