CHAPTER 45

FIDUCIARY LAW IN FINANCIAL REGULATION

HOWELL E. JACKSON AND
TALIA B. GILLIS

I. Introduction

This chapter explores the application of fiduciary duties to regulated financial firms and financial services. At first blush, the need for such a chapter might strike some as surprising in that fiduciary duties and systems of financial regulation can be conceptualized as governing distinctive and nonoverlapping spheres: fiduciary duties police private activity through open-ended, judicially defined standards imposed on an ex post basis, whereas financial regulations set largely mandatory, ex ante obligations for regulated entities under supervisory systems established in legislation and implemented through expert administrative agencies.[1] Yet, as we document in this chapter, fiduciary duties often do overlap with systems of financial regulation.[2] In many regulatory contexts, fiduciary duties arise as a complement to, or sometimes substitute for, other mechanisms of financial regulation. Moreover, the interactions between fiduciary duties and systems of financial regulation generate a host of recurring and challenging interpretative issues.

Our motivation in writing this chapter is to explore the reasons fiduciary duties arise so frequently in the field of financial regulation, and then to provide a structured account of how the principles of fiduciary duties interact with the more rule-based legal

[1] These differences between the two systems are related to the well-established distinction between standards and rules. See, e.g., Louis Kaplow, Rules Versus Standards: An Economic Analysis, 42 Duke L.J. 557 (1992). Although regulatory regimes are often characterized by detailed rules, they often include open-ended provisions, as discussed in Section III.B. For a discussion of principle-based regulation, see Julia Black, Forms and Paradoxes of Principles-Based Regulation, 3 Cap. Mkt. L.J. 425 (2008).

[2] A recently published textbook on financial regulation, to which one of the authors contributed, has some 271 usages of the word fiduciary or variants thereon. See Michael S. Barr et al., Financial Regulation: Law and Policy (2d ed. 2018).

requirements that characterize financial regulation. As grist for this undertaking we focus on a set of roughly two dozen judicial decisions and administrative rulings to illustrate our claims.[3]

This chapter proceeds in three sections, following this introduction: The first section provides a preliminary note on the regulatory perimeters that establish the scope of financial regulations. The second section provides an overview of the ways in which these regimes of financial regulation can overlap with fiduciary duties. Overlap may occur when conduct by firms or individuals falling within a statutorily defined regulatory perimeter also gives rise to a fiduciary duty, typically arising under state law. In such instances, a regulated entity is subject to both a system of financial regulation and an overlapping fiduciary duty. Another way in which overlaps can arise is when a regulatory regime establishes an open-ended standard of conduct—such as a prohibition against fraudulent or deceptive behavior—and then courts or administrative agencies interpret that standard by reference to fiduciary principles or related concepts such as the law of agency. A further category of cases in which regulatory regimes overlap with fiduciary duties arises when the statutory basis of a regulatory regime establishes a fiduciary duty as an explicit feature of the regulatory regime. The third section of the chapter explores a number of recurring issues that arise when fiduciary duties and regulatory requirements overlap.

II. A Preliminary Note on Regulatory Perimeters

Financial regulation is typically administered through government agencies charged with overseeing some segment of the financial services industry. In the United States and many other countries, these agencies have traditionally been structured to police particular sectors of the financial services industry. Elsewhere (for instance, in the United Kingdom) the financial services industry is overseen on a more consolidated basis with a limited number of government bodies dealing with market conduct issues or prudential matters on an industry-wide basis.

A hallmark of all these regulatory systems is the articulation of a regulatory perimeter identifying the kinds of economic activities that must operate within particular regulatory regimes. So, for example, in the United States, the "business of banking" may only be conducted through regulated depository institutions. Firms that trade in or give advice with respect to securities (including investment contracts that have securities-like characteristics) must usually be registered with the Securities and Exchange Commission (SEC) as either broker-dealers or investment advisers or possibly both. And enterprises that engage in the sort of risk sharing associated with insurance products must typically

[3] Many, but not all, of these examples are drawn from Barr, supra note 2.

be licensed as insurance companies, usually under state laws. In other contexts, specific activities, such as the transmission of money or the settlement of real estate transactions, are subject to regulatory regimes (state money transmitter rules or federal requirements for real estate settlements) irrespective of whether the parties engaged in the activities are otherwise regulated entities. Typically these regulatory perimeters are built upon functional (rather than formal) definitions designed to reach a set of economic relations where mandatory public oversight is thought necessary to address potential market failures such as information asymmetries, collective action problems, or negative externalities. Once a firm or individual engages in activities that fall within one of these regulatory perimeters, it becomes subject to a mandatory regulatory regime.[4]

Although the precise contours of regulatory perimeters are occasionally litigated—for example, peer-to-peer lenders for a number of years took the position that their funding strategies did not entail the issuance of securities—financial services firms typically come in short order to accept their legal obligation to comply with the regulatory requirements of their particular supervisory regimes. These regimes characteristically consist of an elaborate set of ex ante requirements and supplemental open-ended duties that govern the operations of regulated entities and police their interactions with the public. The administrative agency overseeing the regulatory scheme commonly provides detailed interpretations of the regulatory requirements and often also plays a major role in ensuring compliance with those requirements through a combination of supervision and enforcement. Taken together, these mechanisms of oversight create a comprehensive and mandatory (that is, nonwaivable) regulatory regime.

At this very high level of abstraction, it is perhaps not unexpected to see some degree of overlap between financial regulation and fiduciary duties. Regulatory regimes and fiduciary duties are frequently concerned with the same behaviors. Relationships that give rise to fiduciary duties often involve one party, the fiduciary, who acts on behalf of the other party, the principal. The fiduciary's privileged position, resulting from their control over the assets of the principal, along with apparent expertise and other attributes, together create a vulnerable relationship warranting the safeguards that fiduciary duties afford.[5] Financial regulation is often preoccupied with similar situations. When financial institutions and financial intermediaries interact with retail customers, and to some degree even when they interact with more sophisticated customers, the institutions and intermediaries are often placed in a superior position due to their control of assets or knowledge resulting in customer reliance. Financial regulation serves to ensure the integrity of financial relationships given these disparities. While the mechanisms of enforcement of fiduciary duties depend more heavily on ex post judicial enforcement,

[4] See id. § 1.3 (exploring the structure of regulatory perimeters in financial regulation).

[5] On the identification of fiduciary relationships, see Daniel B. Kelly, Fiduciary Principles in Fact-Based Fiduciary Relationships, this volume; Paul B. Miller, The Identification of Fiduciary Relationships, this volume. For further theoretical analysis, see Robert H. Sitkoff, An Economic Theory of Fiduciary Law, in Philosophical Foundations of Fiduciary Law 202 (Andrew S. Gold & Paul B. Miller eds., 2014). For an analysis of fiduciary duties in the corporate context, see Oliver Hart, An Economist's View of Fiduciary Duty, 43 U. Toronto L.J. 299 (1993).

the scope of fiduciary duties—that is, their analog to regulatory perimeters in financial regulation—are to some extent analogous to the functional definitions establishing the jurisdictional boundaries of financial regulation.

III. Sources of Overlapping Fiduciary Duties

Broadly speaking, there are three ways in which fiduciary duties can come to overlap with systems of financial regulation. First, the overlap can occur when behavior that falls under the regulatory perimeter also triggers a fiduciary duty that exists outside of the regulatory regime. For purposes of exposition, we will refer to this category as coextensive common law requirements. Next, there are cases where open-ended standards of a regulatory regime are interpreted so as to pick up and incorporate fiduciary principles from common law sources. While these first two categories may sometimes be difficult to distinguish, the key distinction is that the second group arises under elements of the regulatory regime—for example, Rule 10b-5 adopted under the Securities Exchange Act of 1934—as opposed to arising under contract or common law sources. A third category is where regulatory regimes expressly impose fiduciary duties, as has been done most prominently under the Employment Retirement Income Security Act (ERISA) with respect to employee benefit plans.[6]

A. Coextensive Common Law Requirements

The most frequent common law sources of fiduciary duties overlapping with regulatory regimes are contracts and the law of agency. For contracts, fiduciary duties can arise as a result of explicit contractual terms but can also be inferred from the overall structure of a contractual relationship.

1. *Contracts with Explicit Invocation of Fiduciary Obligations*

One way that financial regulation can overlap with a fiduciary duty is when an entity falling under the regulatory perimeter enters into a contract that creates a fiduciary duty.

[6] Another way in which fiduciary duties and regulation can interact is when the existence of a regulation informs the content of fiduciary duties. The introduction to the Restatement (Third) of Agency illustrates this point: "Increasingly, statutes influence common-law development…" (Am. Law Inst. 2006). The introduction goes on to describe the various ways in which statutory and administrative requirements shape the law of agency. For example, through durable powers a principal can convey authority to an agent that is not revoked by the principal's loss of competence. Id. Provisions for durable powers are new to the Restatement (Third), thanks to their statutory recognition. Overlaps of this sort are not otherwise considered in this chapter.

This tends to happen when a financial institution renders services to which fiduciary duties apply, such as when acting as an agent on behalf of a client or becoming a trustee.

Consider a national bank that provides trust services. National banks are supervised by the Office of the Comptroller of the Currency (OCC), but when a national bank serves as a trustee, its service triggers trust law. The role of the bank as a fiduciary is explicitly recognized in the regulatory framework, which includes detailed conduct and disclosure requirements.[7] However, a national bank acting as a trustee will also be subject to the fiduciary duties applying to trusts in general.[8] Given the business model of commercial banks, there are several ways in which a bank providing trust services may be implicating general fiduciary requirements. For example, a conflict could arise between the fiduciary status of the trustee, which requires the trustee to use all available information in making an investment decision with the trust funds, and a regulatory prohibition on insider trading to which the bank is subject.[9]

2. *Implicit Fiduciary Duties Arising under Contract*

Regulated entities entering a contractual arrangement may implicitly create a fiduciary duty even if the duty is not explicitly mentioned in the contract.[10] Such a duty may be implied by the relationship created by the contract, particularly when the contractual arrangement provides discretion by one party over the resources of the other. An example of this phenomenon can be found in *Anwar v. Fairfield Greenwich Ltd.* (*Anwar*).[11] The plaintiffs in *Anwar* were investors in a group of hedge funds. The hedge funds had invested in Bernie Madoff's Ponzi scheme, and entities within the Citco group had provided administrative and custodial services to the hedge funds. As there was no direct contract between Citco entities and the hedge fund investors, Citco argued that no contractual fiduciary duty had been created with respect to the investors. The court, however, ruled that "a fiduciary duty can arise from—but remain independent of—a contractual obligation."[12] In rejecting the defendants' motion to dismiss, the court concluded that Citco's contractual obligations, which included responsibilities such as preparing monthly financial statements and calculating the Net Asset Value (NAV) of the securities, had created an independent fiduciary duty to the investors who had trusted and relied on Citco. Thus, in *Anwar*, a fiduciary duty existed where a third party to a contract

[7] 12 C.F.R. §§ 9.1–9.20 (1996).

[8] See Robert H. Sitkoff, Fiduciary Principles in Trust Law, this volume. For an understanding of the way in which regulators are aware of the overlapping regimes, see Comptroller of the Currency, Investment Management Services: Comptroller's Handbook (2001).

[9] For a discussion of these two competing obligations, see Steven R. Hunsicker, Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions, 50 S. Cal. L. Rev. 611 (1977). Banks have also been accused of self-dealing when investing trust funds. See Martin E. Lybecker, Regulation of Bank Trust Department Investment Activities, 82 Yale L.J. 977 (1973). Some jurisdictions impose a broader fiduciary duty on banks. In Israel, for example, banker-customer relationships are subject to a fiduciary duty. For a discussion, see Ruth Plato-Shinar, The Banking Contract as a Special Contract: The Israeli Approach, 29 Touro L. Rev. 721 (2013).

[10] See James J. Edelman, When Do Fiduciary Duties Arise?, 126 L.Q. Rev. 302 (2010).

[11] 728 F. Supp. 2d 372 (S.D.N.Y. 2010).

[12] Id. at 440.

performed key responsibilities that gave the third party control of the hedge funds' assets and established a relationship of reliance.[13]

3. *Overlaps from the Law of Agency*

Another type of overlap between regulatory requirements and fiduciary duties happens when a regulated party engages in an activity to which fiduciary duties apply because an agency relationship has been created.

An agency relationship exists when two parties enter an agreement in which one will act on behalf of the other and be subject to their control.[14] Such an overlap can arise if an insurance broker is considered an agent of the client, giving rise to a fiduciary duty in addition to the regulatory regime that applies to insurance brokers. The role of insurance broker-as-agent, and the question of whether they should be considered fiduciaries, have been discussed extensively in the literature.[15] Because state law generally governs the business of insurance, the obligations and liabilities of brokers differ by state.[16] In some states, particular types of relationships with insurance brokers will give rise to a broader duty to advise, which possibly encompasses a fiduciary duty. This type of special relationship may be inferred from the broker receiving compensation beyond the insurance premiums or from the insured relying on the broker's expertise on questions such as coverage.[17]

Another example of such an overlap between the law of agency and a regulatory regime can be found in the case of *Koch v. First Union Corp.* (*Koch*).[18] There, the plaintiffs were homeowners who had obtained financing for home repairs and improvements. The transactions in question were clearly covered by the federal Real Estate Settlement Procedures Act (RESPA), and it was also clear that defendants had failed to satisfy RESPA provisions requiring the delivery of a "good faith estimate" of the mortgage charges and other information. The plaintiffs, however, could not obtain judicial relief under RESPA, according to the *Koch* court, because the Act did not provide a private right of action for inaccurate disclosures. The court, however, allowed the plaintiffs to seek redress by alleging a breach of a fiduciary duty arising as a result of the relationship between the

[13] Miller characterizes this type of identification of fiduciary relationships as fact-based analogical reasoning. Courts often do not provide a definition of a fiduciary; they rather argue that the type of role fulfilled by insurance brokers shares common characteristics to those of fiduciaries. See Daniel B. Kelly, Fiduciary Principles in Fact-Based Fiduciary Relationships, this volume, at ~~[x]~~; Paul B. Miller, The Identification of Fiduciary Relationships, this volume, at ~~[x]~~.

[14] See Deborah A. DeMott, Fiduciary Principles in Agency Law, this volume, at ~~[x]~~.

[15] See, e.g., Colin Sammon, Insurance Agent and Broker Liability: Crossing the Two Way Street, 29 Ohio N.U. L. Rev. 237 (2002); Douglas R. Richmond, Insurance Agent and Broker Liability, 40 Tort Trial & Ins. Prac. L.J. 1 (2004).

[16] Some states have explicitly recognized brokers as fiduciaries to the insured. See, e.g., Aden v. Fortsh, 776 A.2d 792 (2001) (finding that a fiduciary relationship exists between an insurance broker and a client given the complexity of the insurance industry).

[17] Many cases discuss when such a special relationship exists, although courts seem hesitant to hold that such a relationship existed. See, e.g., Murphy v. Kuhn, 682 N.E.2d 972 (N.Y. 1997) (holding that while a special relationship could give rise to additional obligations, such a relationship did not exist in the case at hand).

[18] Nos. CONTROL 100727, CONTROL 100746, 2002 WL 372939 (Pa. Ct. C.P. Jan. 20, 2002).

homeowners and the contractor and broker, a relationship characterized as a confidential one between parties that do not deal on equal terms.[19] Thus, the same misleading disclosure that constituted a violation of RESPA's requirements was also a critical element of the plaintiff's claim for a fiduciary breach. Hence, there was an overlap of regulatory requirements and fiduciary law.

B. Fiduciary Duties Arising under Open-Ended Provisions of Regulatory Statutes

Through interpretation of open-ended statutory standards, courts and administrative agencies frequently impose fiduciary duties and similar obligations onto regulatory regimes that make no direct mention of fiduciary law.

An excellent and early example is the Second Circuit's 1943 decision *Charles Hughes & Co. v. SEC*.[20] In that case, the SEC was bringing an enforcement action against a securities firm under two antifraud provisions: Section 17 of the Securities Act of 1933 and Section 15(c) of the Securities Exchange Act of 1934. Neither provision imposes an explicit fiduciary duty, but rather the provisions establish open-ended prohibitions of material misrepresentations, frauds, deception, and manipulation. Relying solely on these legal requirements, the Second Circuit's decision articulated what has come to be known as the "Shingle Theory" of broker-dealers. Under that theory, when a regulated broker-dealer does business with a customer, even if not serving as an agent of the customer, the firm is "still under a special duty, in view of its expert knowledge and proffered advice, not to take advantage of its customers' ignorance of market conditions."[21] In failing to explain to its customers the manner in which it priced its securities, the firm was found to have violated this "special duty" and hence was subjected to disciplinary action.

In *Charles Hughes*, the Court accepted for purposes of its analysis that the firm in question was acting solely as a principal in a vendor-purchaser relationship with its customer and not as an agent or broker for that customer. In most other cases where fiduciary duties have been imposed on securities firms, there is an agency-like relationship, an advisory relationship, or sometimes both. The 1949 case of *Arleen Hughes v. SEC*,[22] for example, also dealt with excessive markups by a broker-dealer under basic antifraud provisions of federal securities laws. However, in *Arleen Hughes* it was uncontested that the firm in question was serving as both broker-agent and adviser of its clients, leading both the SEC and the court to conclude that the firm was in a fiduciary relationship with its clients. In finding that the securities firm in question had violated those duties, the court was clear that it was not relying on common law standards, but rather was enforcing

[19] It is clear through the decision the court references in its discussion of the fiduciary duty that it considers the defendants as agents of the plaintiff, although the court does not explicitly label them as such.

[20] 139 F.2d 434 (2d Cir. 1943). [21] Id. at 437.

[22] 174 F.2d 969 (D.C. Cir. 1949). For another take on this topic, see Randall W. Quinn, Deja Vu All Over Again: The SEC's Return to Agency Theory in Regulating Broker-Dealers, 1990 Colum. Bus. L. Rev. 61.

open-ended standards established under federal securities laws, and even questioned the extent to which clients could waive such conflicts.

The overlap between an agency-like relationship and an advisory relationship is hardly surprising, as the Securities Exchange Act of 1934 uses the language of agency to define a broker as "any person engaged in the business of effecting transactions for the account of others,"[23] and the Investment Advisers Act of 1940[24] reaches those who give advice with respect to securities. What is somewhat surprising is that federal courts and administrative agencies have used this overlap to develop a distinctive federal system of fiduciary-like duties arising under federal securities law but drawing on common law principles. Numerous cases and administrative orders after *Arleen Hughes* confirm the proposition that securities firms acting as agents or advisers for their clients operate under some form of federal fiduciary duty.[25] Characteristically, these disputes arise in situations where the securities firm also engages in some other economic activity that is arguably in conflict with the interests of a customer for whom the firm is also serving as a broker-agent.

Case law arising under Section 206 of the Investment Adviser Act offers another classic example of an open-ended statutory requirement giving rise to a fiduciary duty. Section 206 is an antifraud provision that prohibits an investment adviser from engaging in any activity that is fraudulent, deceptive, or manipulative. Although the section does not contain any explicit reference to a fiduciary duty, in the seminal case *SEC v. Capital Gains Research Bureau*,[26] the U.S. Supreme Court found that the Advisers Act "reflects a congressional recognition" of the fiduciary nature of an investment advisory relationship.[27] Although some have questioned whether the Supreme Court in *Capital Gains* actually held that Section 206 established a fiduciary duty of investment advisers or merely declared the existence of a fiduciary duty between an adviser and client,[28] the decision is often interpreted as establishing that Section 206 created not only a fiduciary duty to refrain from the negative behaviors explicitly listed in Section 206 but also positive duties to act in the best interest of clients.[29]

C. Statutes Establishing Explicit Fiduciary Standards

In addition to general provisions that have been interpreted as creating a fiduciary duty for actors falling within the regulatory perimeter, there are several regulatory statutes that explicitly establish fiduciary duty obligations for regulated entities. The statutes also

[23] § 3(4), 15 U.S.C.A. § 78a (2016).

[24] Investment Advisers Act of 1940 (1940) (codified as amended at 15 U.S.C.A. § 80b-20 (2015)).

[25] See E.F. Hutton & Co., Exchange Act Release No. 34-25887, 1988 WL 901641 (July 6, 1988); Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970); Mihara v. Dean Witter & Co., 619 F.2d 814 (9th Cir. 1980); Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266 (3d Cir. 1998).

[26] 375 U.S. 180 (1963). [27] Id. at 191.

[28] See Arthur B. Laby, SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940, 91 B.U. L. Rev. 1051 (2011).

[29] For further discussion of the fiduciary duties of investment advisers, see Arthur B. Laby, Fiduciary Principles in Investment Advice, this volume.

sometimes set forth specific subsidiary obligations of prudence and loyalty embracing concepts and formulations that would be familiar and congenial to reporters of the Third Restatement of Trusts. An important example is the Employment Retirement Income Security Act (ERISA), which sets out the rules governing employee benefit plans as discussed in detail elsewhere in this *Handbook*.[30] ERISA defines any person who performs certain functions with respect to enumerated pension, retirement, or welfare plans to be a fiduciary.

Another example of a regulatory statute explicitly articulating a fiduciary duty is the Investment Company Act of 1940 (1940 Act).[31] Section 36(a) of the 1940 Act allows the SEC to bring enforcement actions with respect to "a breach of fiduciary duty involving personal misconduct in respect of any registered investment company" by various investment company actors.[32] In contrast with ERISA, which established a more canonical form of fiduciary duties, the language of Section 36(a) is a bit ambiguous in limiting its prohibitions to fiduciary breaches "involving personal misconduct." Most subsequent case law, however, has interpreted the section as creating a general fiduciary duty.[33] A separate and also explicit fiduciary duty is established under Section 36(b) of the Act, which imposes "fiduciary duty with respect to the receipt of compensation" of investment advisers of investment companies.[34]

IV. Challenges of Overlapping Fiduciary Duties

We turn now to a series of recurring issues that arise when fiduciary duties overlap with regulatory requirements. To an extent, our selection of issues is idiosyncratic and reflects a range of contexts and complexities. The one common theme that runs through all examples is a need to balance the flexible nature of fiduciary duties with the more rigid contours of regulatory regimes in a manner that achieves the equitable goals of fiduciary duties while acknowledging the practical requirements of regulated firms seeking to succeed in a competitive business environment.

A. The Scope of the Fiduciary Duty

An initial question concerns the scope of the fiduciary duty in question. Even if one accepts that a fiduciary duty exists, it is not always obvious how far that duty extends.

[30] See Dana M. Muir, Fiduciary Principles in Pension Law, this volume.

[31] Investment Company Act of 1940 (1940) (codified as amended at 15 U.S.C.A. § 80a-51 (2010)).

[32] Id. at § 36(a).

[33] See William K. Sjostrom, Jr., Tapping the Reservoir: Mutual Fund Litigation Under Section 36(a) of the Investment Company Act of 1940, 54 U. Kan. L. Rev. 251 (2005).

[34] Investment Company Act § 36(b).

Issues of scope frequently arise when a regulated firm's fiduciary relationship with a client only involves one service among a number of services provided by the firm, or when a service to the client is only part of the overall relationship between a financial actor and the client (for example, when a broker-dealer with fiduciary obligations in one area also provides ancillary services in what would otherwise appear to be arm's-length transactions).

A dispute of this sort arose in the 1970 case *Chasins v. Smith*, where a broker-dealer acted as a broker for a client with respect to securities sold in transactions for which the broker-dealer also acted as a market maker.[35] The court addressed the question of whether the firm's fiduciary duty to the client would cover the market-making activity of the broker-dealer even though the firm's direct relationship with the client was restricted to brokerage activities. At the time, the SEC's disclosure rules required broker-dealers to provide clients information regarding the basic terms of the transaction, but did not require disclosure of market-making status. Nevertheless, the court, relying on the open-ended requirements of Rule 10b-5, found that the omission of a material fact could also cover market-maker status. The court ruled that the disclosure of market-maker status should have been made, expanding the scope of the firm's fiduciary duty to include a requirement to disclose information beyond the SEC's then applicable disclosure rules.[36]

Issues of scope can also arise under statutory fiduciary requirements. A compelling example is the recently adopted (but now possibly derailed) fiduciary duty rule promulgated by the Department of Labor (DOL) late in the second term of the Barack Obama administration.[37] The content of the new rule and the safe harbor relief the DOL simultaneously adopted are explored in detail elsewhere in this volume.[38] For our purposes, what is striking about the DOL's initiative is that, by rulemaking procedures, the DOL substantially extended the scope of ERISA's fiduciary duties to embrace, among other things, Individual Retirement Accounts (IRA) that had previously been understood to fall outside of ERISA's fiduciary requirements. In reviewing the rule, a divided panel from the Fifth Circuit concluded that the DOL had exceeded its statutory powers in extending ERISA's fiduciary obligations so far.[39]

[35] 438 F.2d 1167 (2d Cir. 1971).

[36] See E.F. Hutton & Co., Exchange Act Release No. 34-25887, 1988 WL 901641 (July 6, 1988) (by accepting a limit order from customer, firm found to have a fiduciary duty not to trade ahead of customer absent clear disclosure). See also Order Execution Obligations, 61 Fed. Reg. 48,290 (Sept. 12, 1996) (codified at 17 C.F.R. pt. 240) (adopting new Rule 11Ac1-4 and amending Rule 11Ac1-1).

[37] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20946 (Apr. 8, 2016) (codified at 29 C.F.R. pt. 2509). On February 3, 2017, President Donald Trump signed a Presidential Memorandum directing the Department of Labor to examine the Fiduciary Duty Rule, so it is possible that this rule will change in the future.

[38] See Laby, supra note 29.

[39] Chamber of Commerce of the U.S. v. U.S. Dep't of Labor, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018).

B. The Intensity of the Fiduciary Duty

Even once the scope of a fiduciary duty is established its intensity can vary from context to context. This variation in intensity is nowhere more apparent than in the duties of broker-dealers and investment advisers with respect to the advice they give their clients, another topic discussed in detail in this volume.[40] As outlined in Section III.B. both broker-dealers giving advice to their clients and pure investment advisers have been considered fiduciaries. But investment advisers are considered to have a stronger fiduciary duty, which requires them to act in their clients' best interests and provide more elaborate disclosures of conflicts. Broker-dealers, on the other hand, have traditionally been considered to have a more limited obligation with respect to the transactions for which they give advice to their clients. This obligation of broker-dealers is often referred to as a "suitability" requirement.[41]

The doctrinal line between when a broker-dealer can operate under the lesser suitability standard and the higher Advisers Act standard is often fuzzy and has changed over time. In the past, the SEC apparently took the view that broker-dealers with discretion over trading securities in a brokerage account did not need to register under the Advisers Act, provided the firm did not receive separate compensation (beyond ordinary commissions) for its advice. In a 2005 rulemaking, however, the SEC altered this interpretation and concluded that broker-dealers with trading discretion should register under the Advisers Act, even if all of their compensation came in the form of commissions.[42]

Recent debates on the harmonization of the duties of broker-dealers and investment advisers ask whether a fiduciary duty should be applied to broker-dealers, rather than whether the current duty should be modified or extended, implying that the "suitability" requirement is not a fiduciary duty. In our taxonomy, however, the suitability requirement is more accurately characterized as a less intensive form of fiduciary duty than the one imposed under the Advisers Act.[43] The broker-dealer's "suitability"

[40] See Laby, supra note 29.

[41] See Financial Industry Regulatory Authority, FINRA Manual, Rule 2111 (2010), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 (requiring that "a recommended transaction or investment strategy . . . is suitable for the customer."). In enforcing the suitability rule, the Financial Industry Regulatory Authority (FINRA) has required that a broker-dealer's recommendation be in the best interest of the customer.

[42] The evolution of the SEC's position on this point is nicely summarized in Diane Ambler et al., Untangling *Financial Planning Association v. Securities and Exchange Commission*: The Future of Fee-Based Brokerage Accounts, Fee-Based Brokerage: What to Do Next? (K&L Gates Newsletter), July 12, 2007. Interestingly, even though a court ultimately invalided the rulemaking in which the latter position was articulated, see Fin. Planning Ass'n v. SEC., 482 F.3d 481 (D.C. Cir. 2007), the SEC still takes the position that broker-dealers with discretion over trading accounts must register under the Advisers Act.

[43] Support for this approach can be found in the 2011 SEC study on the harmonization of fiduciary duties: "While broker-dealers are generally not subject to a fiduciary duty under the federal securities laws, courts have found broker-dealers to have a fiduciary duty under certain circumstances." Staff of the SEC, Study on Investment Advisers and Broker-Dealers iv (January 2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf. For further discussion of the ambiguity around the SEC rulemaking authority under § 913(g), see Arthur B. Laby, Implementing Regulatory Harmonization at the SEC, 30

requirement—along with the related requirement that broker-dealers know their customers—tracks the essence of a fiduciary duty: legal obligations that arise out of the nature of the relationship between a firm and its customers.[44] While the duties of broker-dealers are not currently as onerous as those of investment advisers, they remain at root fiduciary in nature.

C. The Content of Fiduciary Duties

What is the content of fiduciary duties in the context of a regulated firm? Fiduciary duties are often summarized as consisting of a duty of care and a duty of loyalty. However, fiduciary law as applied in the context of regulated financial services firms does not usually follow this structure.[45] We therefore organize this section following the structure of the regulatory toolkit familiar to scholars of financial regulation. Our first category covers rules of conduct where regulated entities are either required to take or forbidden from taking specified actions. Our second category includes disclosure and consent obligations that require the entity to provide information and possibly also secure the principal's consent prior to action. As described Section 2.iii., disclosure and consent requirements can be so onerous that they approximate rules of conduct. Our third category of content consists of obligations that are purely (or largely) process-based. These categories contain obligations that are similar to the requirements of the duties of loyalty and care that organize other areas of fiduciary law. However, because courts and agencies do not apply these doctrines directly, we follow the articulation of the regulatory toolkit.

1. *Rules of Conduct*

We outline in the following subsections several instances in which judicial interpretations of fiduciary duties applicable to broker-dealers have come to establish mandatory rules of conduct. As noted in the footnotes, there are other analogous situations in which regulatory agencies have adopted regulatory requirements under open-ended, fiduciary-like standards with similar effects. But in the main text we focus on judicial interpretations.

Rev. Banking & Fin. L. 189 (2010). For further discussion of whether courts have held that broker-dealers owe a general fiduciary duty toward customers, see Arthur B. Laby, Fiduciary Obligations of Broker-Dealers and Investment Advisers, 55 Vill. L. Rev. 704 (2010). Laby argues that most state courts have held that broker-dealers do not owe a general fiduciary duty to customers absent special circumstances, such as the presence of a discretionary account. Laby provides an account for why the exact scope of broker-dealer fiduciary duties has not been clearly articulated by the SEC. Others have argued that the courts have held that the fiduciary duties of broker-dealers are well established. See, e.g., Thomas Lee Hazen, Are Existing Stock Broker Standards Sufficient? Principles, Rules, and Fiduciary Duties, 2010 Colum. Bus. L. Rev. 710 (2010).

[44] See, e.g., FINRA, Regulatory Notice on the SEC approval of Know-Your-Customer and Suitability Obligations (2011), http://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf.

[45] Few of the decisions explored in this chapter conceptualize disputes as arising under a duty of loyalty or a duty of care. Only in the case law arising under ERISA—which most closely and explicitly tracks traditional fiduciary law—do courts routinely invoke the Restatement of Trusts and apply familiar fiduciary law principles.

I. CONFLICTED COMPENSATION

One of the central conduct duties of a fiduciary is to avoid acting in a way that generates a potential advantage for the fiduciary to the detriment of the client. While conflicts of this sort can sometimes be addressed through disclosure and consent, one can also identify examples of more stringent conduct requirements. A nice example of a prohibited form of compensation is churning, whereby a broker excessively trades a client's account to generate commissions. In *Mihara v. Dean Witter & Co.*, for example, the court determined that a broker, who had effective control of a client's account, had engaged in prohibited churning by excessively buying and selling securities despite the investment objectives being conservative.[46] Importantly, the court found that providing the client with information about the specific trade was not equivalent to notifying the client of excessive trading, and therefore notification regarding individual trades was not a defense for churning.[47]

II. KNOW YOUR SECURITIES REQUIREMENTS

Another example of a rule of conduct—this one establishing an affirmative duty to act—can be seen in the 1970 case *Hanly v. SEC*.[48] In that case, a securities firm recommended securities to its customers without doing any meaningful research into the companies involved. Speaking the language of fiduciary duties—and invoking the same open-ended statutory standards discussed earlier—the court reasoned: "A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders."[49] By failing to abide by this "duty to investigate," the securities firm in question became subject to administrative sanctions and potentially civil liability as well.[50]

[46] 619 F.2d 814 (9th Cir. 980).

[47] A similar approach was taken with respect to the compensation of financial advisers dealing with retirement savings. In a report discussing the effect of conflicted investment advice on retirement saving, the Council staff concluded that since fees and commissions could vary to a considerable degree based on the product an adviser recommends, these compensation arrangements arguably could distort the advice given to clients. The Council of Economic Advisers, The Effects of Conflicted Investment Advice on Retirement Savings (2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf. In an ensuing rulemaking effort culminating in its fiduciary rule, the Department of Labor prohibited financial advisers from receiving commissions unless the advisers comply with the restrictions or an elaborate safe harbor provision. See Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,946 (Apr. 8, 2016) (codified at 29 C.F.R. pt. 2509) (revisions to the definition of fiduciary); id. at 21,002 (exemption for best-interest contracts).

[48] 415 F.2d 589 (2d Cir. 1969). [49] Id. at 596.

[50] Another type of conduct requirement relates to the type of products that a fiduciary is prohibited from selling to a customer or about which the fiduciary cannot give advice. Products that are sold to customers must be suitable, and fiduciaries are often required to exert reasonable effort to determine whether certain investments or products are suitable. This entails a certain level of knowledge about the client and his or her preferences. Therefore, satisfying the fiduciary requirement often involves eliciting information from the client during the first engagement with the client—such as the client's risk tolerance and financial goals—and thereafter periodically. FINRA Rule 2111 requires broker-dealers to understand the products they recommend and consider the specific characteristics of the client as well as their investment objectives. Financial Industry Regulatory Authority, FINRA Manual, Rule 2111 (2010),

2. *Disclosure and Consent*

The fiduciary duties of regulated entities can also take the form of disclosure requirements or sometimes disclosure and consent requirements. Rather than mandating specific forms of conduct, disclosure and consent duties create procedural protections for clients. Disclosure and consent requirements are closely linked because absent adequate disclosure of information, the fiduciary lacks the appropriate consent of the principal for their actions.

I. SIMPLE DISCLOSURE REQUIREMENTS

Several cases have found a breach of a fiduciary duty when key information regarding the terms of engagement with the fiduciary were not disclosed or when information disclosed was misleading.

Such was the case in *Koch*, discussed earlier, in which the defendants failed to adequately disclose several costs of the mortgage, such as the closing costs and the origination fee of the loan.[51] The court found that by providing misleading information, the defendants had breached their fiduciary duty. Similarly, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*, the court found that a broker-dealer breached their duty as an agent by not providing clients with details regarding their available courses of action following an unauthorized transaction.[52] Courts have also found that withholding market information relevant to a transaction may also be a breach of the fiduciary duty. For example, courts have found that not disclosing the market price of securities when they are sold significantly above market price is a breach of the broker-dealer's fiduciary duty.[53]

II. DISCLOSURE PLUS CONSENT

In certain contexts, fiduciary duties imposed on regulated entities specify not just disclosure to the client but also some form of affirmative consent. For example, the *Manning* case dealt with a broker-dealer who gave preference to proprietary transactions over a customer order.[54] In the *Manning* case, the SEC stated that this conduct would have been permissible had this been disclosed to the customer ahead of time and had the customer consented to this conduct.

III. DISCLOSURE AND CONSENT REQUIREMENTS THAT APPROXIMATE RULES OF CONDUCT

The relationship between conduct duties and disclosure-and-consent requirements bears further consideration. Conduct duties often provide the baseline for a fiduciary

http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859. Rule 2090, known as the "know your customer" rule, creates further diligence requirements in obtaining information about the customer in order to make the recommendation. Id. Rule 2090. In contrast to the rule of conduct discussed in the main text, the suitability requirement has been articulated in rulemaking proceedings.

[51] Koch, 2002 WL 372939.

[52] 901 F.2d 1124 (D.C. Cir. 1990).

[53] Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (2d Cir. 1943).

[54] E.F. Hutton & Co., Exchange Act Release No. 34-25887, 1988 WL 901641 (July 6, 1988). The case is called the *Mainning* case after the name of the complainant.

duty from which the fiduciary may not deviate unless he provides adequate disclosure and obtains consent from the customer. And, if the disclosure-and-consent requirement is sufficiently stringent, the requirement may, in practice, produce a rule of conduct.

Consider the difference between an ex ante consent requirement versus an ex post consent requirement. With an ex ante consent requirement, a fiduciary may receive prior consent to engage in numerous future transactions. With an ex post consent requirement, however, a fiduciary must obtain consent for every transaction falling within a certain category. For example, when an investment adviser trades with a client as principal, they must obtain consent for every such transaction, as required by Section 206(3) of the Advisers Act. In practice, such a consent requirement creates an insuperable barrier to certain kinds of transactions, effectively approximating a rule of conduct.[55]

3. *Fiduciary Duties That Devolve into Procedural Requirements*

One also encounters fiduciary duties in the context of regulated entities that have been interpreted to impose something that looks, on the ground, to operate more in the form of a procedural requirement. Take, for example, Section 36(b) of the 1940 Act, which, as discussed earlier, establishes a fiduciary duty with respect to compensation of investment advisers to registered investment accompanies. As articulated in the seminal case of *Gartenberg v. Merrill Lynch Asset Management*,[56] and subsequently adopted by the Supreme Court in *Jones v. Harris Associates*,[57] this particular fiduciary duty has largely been reduced to a series of procedural steps that the independent directors of investment must follow in approving advisory contracts during an annual contract renewal process mandated under Section 15(c) of the 1940 Act. While some substantive constraints on adviser compensation exist at the margins—forming a rule of conduct for such cases—the fiduciary duties of Section 36(b) serve largely to provide mutual fund investors with procedural safeguards.[58]

D. Interactions between Fiduciary Duties and Regulatory Requirements

As we have seen in Section III, fiduciary duties and financial regulation frequently overlap. These overlaps generate a number of recurring phenomena regarding interactions between fiduciary duties and regulatory requirements.

[55] For a discussion of instances where the SEC under Section 206(3) has both authorized ex ante disclosure and declined to authorize such disclosures, see Diane Ambler et al., supra note 42, at 3 (contrasting agency cross transactions where ex ante consent is permitted from principal trades where it is not).

[56] 694 F.2d 923 (2d Cir. 1982). [57] 559 U.S. 335 (2010).

[58] A similar point could be made about securities firms' duty to provide their customers "best execution" on securities transactions, another obligation on regulated entities with common law origins. Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 270 (3d Cir. 1998). ("The duty of best execution, which predates the federal securities laws, has its roots in the common law agency obligations of undivided loyalty and reasonable care that an agent owes to his principal.").

1. *Codification of Fiduciary Duties into Regulatory Requirements*

One common form of interaction occurs when a regulatory regime codifies the content of a fiduciary duty. This often happens after a court has established some standard of conduct through a judicial interpretation of a fiduciary standard and then a regulatory agency modifies a codified regulatory requirement to incorporate the content of the fiduciary duty.[59]

There are many examples of this codification process. In the late 1930s and early 1940s, in a series of cases, the SEC established the "Shingle Theory" discussed earlier in this chapter.[60] Following several court decisions along similar lines, the National Association of Securities Dealers ("NASD") later superseded by the Financial Industry Regulatory Authority's (FINRA) created rules that relate to fair compensation. Rule 2121 required broker-dealers who bought or sold from their own account to set the price of the security fairly and, when acting as an agent, not to charge more than a fair commission.[61] In interpreting this rule, the NASD created the "5% policy" according to which a markup above 5 percent is presumed to be excessive; at the same time, the NASD provided a detailed list of considerations for determining whether a markup is excessive in any particular case.[62]

2. *Fiduciary Duties beyond Regulatory Requirements*

Another kind of interaction occurs when a regulatory requirement has already been established with respect to a particular issue and then a claim arises that a fiduciary duty covers the same subject matter but imposes legal obligations beyond those set out in the regulatory requirement.

The existence of disclosure obligations beyond the scope of securities regulation was discussed in *United States v. Skelly*.[63] That case dealt with a broker-dealer that offered its registered representatives higher compensation if they offered securities that were part of a "pump and dump" scheme. One allegation the firm faced was that registered representatives were required to disclose the large commissions the representatives were to receive for sales of the fraudulent securities. According to the court, "no SEC rule requires the registered representatives who deal with the customers to disclose their own compensation, whether pegged to a particular trade or otherwise."[64] Instead, the obligation to disclose compensation was based on the parallel and general disclosure norms required

[59] This type of codification should be distinguished from cases in which legislation explicitly incorporates fiduciary duties, such as ERISA, discussed infra in Section III.C.

[60] See Louis Loss, The SEC and the Broker-Dealer, 1 Vand. L. Rev. 516 (1947). Loss coined the expression "Shingle Theory."

[61] Financial Industry Regulatory Authority, FINRA Manual, Rule 2121 (2010), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11539.

[62] Similarly, following the court's decision in *Hanley v. SEC*, the SEC adopted detailed requirements of information a broker dealer must acquire prior to a recommendation in Rule 15c2-11. See also Financial Industry Regulatory Authority, FINRA Manual, Rule 2111 (2010), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 (the suitability rule).

[63] 442 F.3d 94 (2d Cir. 2006).

[64] Id. at 97.

of a fiduciary.[65] The Court's decision seems consistent with the more general approach to fiduciary duties as "gap fillers." According to this approach, fiduciary duties have often developed into implementing rules that dictate how the duty applies in a particular circumstance, thereby reducing decision costs and uncertainty. However, the general standards prescribed by fiduciary law continue to apply as a means of reducing transaction costs and error costs.[66] This approach of fiduciary duties as "gap fillers" has been applied to many areas of law, including corporate law.[67]

Another way to consider the parallel existence of regulatory regimes and fiduciary duties is through the lens of state and federal law. In *O'Malley v. Borris*, the court considered whether a disclosure about a change to a money market "sweep" account sent to clients was adequate, given that it did not disclose that this change was beneficial to the broker.[68] The court determined that "[t]he relationship between a customer and stock broker is that of principal and agent."[69] One of the issues discussed by the court was whether fulfilling the NASD requirements on use of negative response letters, created to relieve the burden of obtaining approvals from each customer individually, preempted state law fiduciary disclosure of conflicts of interest. The court, however, found that the state fiduciary requirements existed in parallel to then-applicable NASD rules.[70]

On the other hand, the court in *O'Malley* did distinguish its decision from a case in which regulatory requirements should be considered exhaustive. The court found that if the regulatory rule was intended to create a "safe harbor," then the application of fiduciary duties in parallel may create a conflict between state and federal law.[71] According to this understanding, the application of fiduciary duties may be modulated if the regulatory regime considered the specific conduct extensively and intended to create a comprehensive rule of conduct.[72]

[65] Similarly, in *Chasins v. Smith, Barney & Co.*, the court reasoned that duties imposed under Rule 10b-5 established an independent disclosure obligation regarding market-maker status, which may include disclosures beyond what is required by SEC Rule 10b-10. 438 F.2d 1167 (2d Cir. 1971).

[66] See, e.g., Robert H. Sitkoff, An Economic Theory of Fiduciary Law, in Philosophical Foundations of Fiduciary Law 202 (Andrew S. Gold & Paul B. Miller eds., 2014).

[67] Early proponents of this approach to fiduciary duties in corporate law were Easterbook and Fischel. See Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 90–93 (1991) (arguing that the fiduciary principle allows for the completion of incomplete contracts due to the high costs of contracting all future contingencies). See also George W. Dent, Jr., Gap Fillers and Fiduciary Duties in Strategic Alliances, 57 Bus. Law. 104 (2001) (arguing that "courts play an important role in supplying the gap-filling default rules and fiduciary duties for strategic alliances.").

[68] 742 A.2d 845 (Del. 1999). [69] Id. at 849.

[70] There are also instances where, despite the general fiduciary standard being translated into detailed rules of conduct, the regulator itself clarifies that its rules should not be considered exhaustive of the general obligation. For a discussion on Form ADV, see Arthur Laby, The Fiduciary Structure of Investment Management Regulation, in Research Handbook on Mutual Funds (John D. Morley & William A. Birdthistle eds., 2018). Similarly, Rule 15c1-2, which prohibits fraudulent, manipulative, and deceptive practices in connection with securities brokerage transactions, clarifies that is not limited to "any specific definitions of the term 'manipulative, deceptive or other fraudulent device or contrivance' contained in other rules adopted pursuant to section 15(c)(1) of the Act." 17 C.F.R. § 240.15c1-2 (1948).

[71] 742 A.2d at 849.

[72] Support for this idea can be found in Third Circuit's en banc decision in Newton, 135 F.3d 266. The court found that the absence of a NASD requirement to consider the prices on an alternative platform to

Conceivably, reasoning of this sort explains why courts and regulatory agencies have been reluctant to extend broker-dealers' investment advice obligations beyond FINRA's suitability requirements, though they have allowed a more expansive fiduciary duty to evolve with respect to investment advisers, who are not subject to similar regulatory requirements and have come to be subject to more onerous fiduciary duty standards.[73]

3. *Fiduciary Duties within a Detailed Statutory Structure*

A distinct set of interactions arise when regulatory regimes explicitly adopt fiduciary requirements but within a detailed statutory structure that departs in critical respects from common law requirements. ERISA provides several examples of this phenomenon.

As discussed in Section III, ERISA defines certain functionaries as fiduciaries as a way to confront the inherent conflicts that may arise in employer-sponsored benefit plans. In addition to ERISA's designation of the functionaries who are considered fiduciaries in Section 3(21),[74] ERISA also includes detailed provisions on the information that must be disclosed to employees, as well as rules that prohibit certain transactions between the plan fiduciaries and the plan.[75] For example, ERISA requires "diversifying the investments of the plan so as to minimize the risk of large losses"[76] and sets down prohibited transactions and the exemptions from those prohibitions.[77]

Since general fiduciary duties are understood as requiring fiduciaries to diversify investments, make material disclosures, and avoid conflicts of interest, there is significant overlap between what is prescribed by the regulatory regime and these general fiduciary requirements. One way to understand this overlap is that people designated as fiduciaries under ERISA must follow the rules and regulations of ERISA rather than apply a source of authority arising out of common law. According to this understanding, the content of the fiduciary duty is provided by ERISA itself. Alternatively, the overarching fiduciary duty could exist alongside the detailed ERISA regulation, requiring conduct or disclosure in certain situations not covered by the rules and regulations. If the fiduciary duty in ERISA is truly to be treated as an import of trust law, the fiduciary duty of an ERISA plan continues to be informed and shaped by the general understanding of trust law fiduciary duty.

An example of a context in which an ERISA regulatory rule can be in tension with general fiduciary duties arises when employee retirement money is invested in company stock in an Employee Stock Ownership Plan (ESOP).[78] ERISA exempts ESOPs from

meet a dealer's duty of best execution does not reflect NASD's close consideration of the matter. For an account of the codification of conduct requirements that replace general standards, see Mercer Bullard, The Fiduciary Study: A Triumph of Substance over Form, 30 Rev. Banking & Fin. L. 175 (2010). For Professor Laby's response, see Arthur Laby, The Fiduciary Structure of Investment Management Regulation, in Research Handbook on Mutual Funds (John D. Morley & William A. Birdthistle eds., 2018).

[73] We discuss this subject in Section IV.B.

[74] ERISA § 3(21), 29 U.S.C. § 1002.

[75] ERISA § 406(a)–(b), 29 U.S.C. § 1106(a)–(b).

[76] ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C).

[77] ERISA §§ 406, 408, 29 U.S.C. §§ 1106, 1108.

[78] ESOPs raise several red flags as they may create a conflict between a company's wish to increase the demand for its stock and the prudent investment of retirement funds.

ERISA's general diversification requirement, as well as its prohibition against affiliated party transactions.[79] In *Fifth Third Bancorp v. Dudenhoeffer*,[80] the Supreme Court considered a case in which plaintiffs argued that the employer knew or should have known that its stock was overvalued and excessively risky, and therefore the employer violated a duty of prudence by allowing its plan to stay invested in employer stock. As a preliminary matter, the Court considered whether the regulatory waiver applicable to ESOPs precluded a claim of an employer's breach of their general fiduciary requirement to act prudently. The court interpreted the waiver for ESOPs narrowly, precluding a claim for losses as a result of the lack of diversification that exists by definition with ESOPs, but not for a general claim of a breach of the duty of prudence. In other words, the Court did not read the provisions of ERISA authorizing the creation of ESOPs as providing a defense against a broad enforcement of the duty of prudence as would have arisen under common law.

Another arguable conflict between the ERISA and traditional fiduciary principles comes in the area of remediation. Whereas common law courts traditionally had fairly broad discretion to remediate fiduciary breaches, ERISA establishes a specific set of remedial provisions. In the 1993 case *Mertens v. Hewitt Associates*, the Supreme Court interpreted the "comprehensive and reticulated" provisions of ERISA to preclude the provision of the kind of broad relief that common law courts might have been able to levy against the non-fiduciary defendant.[81] Thus the relief available to plaintiffs under ERISA has been found to be narrower than that available for those proceeding under traditional trust law.

Yet another area of tension between ERISA and general trust law arises in the context of the standard of review exercised by courts of fiduciary decisions. In *Firestone Tire & Rubber Co. v. Bruch*,[82] the Supreme Court interpreted ERISA in light of what it understood to be principles of trust law and held that the denial of benefits was subject to de novo review unless expressly determined otherwise in plan documents. The Court in *Bruch* thus implicitly invited plan sponsors to contract out of stringent judicial review of fiduciary decisions. Professor John Langbein, a leading scholar of the law of trusts, criticized the *Bruch* decision on the grounds that the Court misinterpreted the general law of trusts.[83] As elaborated in later work, Langbein has argued that fiduciary rules established under ERISA should be interpreted more stringently than the law of private trusts because ERISA created a largely mandatory structure of regulation, whereas the law of private trusts emphasizes the value of accommodating settlor autonomy.[84] In contrast to the Court's decision in *Bruch*, Langbein's approach would give priority to the regulatory purpose and intention of ERISA over general principles of trust law.

[79] See ERISA § 404(a)(1)(C)–(2), 29 U.S.C. § 1104(a)(1)(C)–(2).

[80] 134 S. Ct. 2459 (2014).

[81] 508 U.S. 248 (1993) (quoting Nachman Corp. v. Pension Benefit Guaranty Corp., 446 U.S. 359, 361 (1980)). See also Great-West Life & Annuity Insurance Co. v. Knudson, 534 U.S. 204 (2002).

[82] 489 U.S. 101 (1989).

[83] John H. Langbein, The Supreme Court Flunks Trusts, 1990 Sup. Ct. Rev. 207 (1990). See also Bullard, supra note 72.

[84] John H. Langbein, Trust Law as Regulatory Law: The Unam/Provident Scandal and Judicial Review of Benefit Denials Under ERISA, 101 Nw. U. L. Rev. 1316 (2007).

V. Conclusion

The challenges that arise from the frequent overlap between regulatory regimes and fiduciary duties persist in many areas of financial regulation. In some cases, this overlap is intentional, such as when statutes incorporate fiduciary duties or use open-ended provisions that are interpreted as fiduciary duties. In other instances, regulators attempt to codify judicial interpretations of fiduciary duties into detailed regulatory requirements. In yet other contexts, the fiduciary duty exists in parallel to the regulatory regime without explicit regulatory recognition. This chapter identifies the recurring issues that exist in all of these types of cases, discussing how the scope and intensity of the fiduciary duty may vary, depending on how the regulatory regime and the fiduciary duty interact and whether they are substitutes or complements.

The harmonization of broker-dealer and investment adviser duties, currently the subject of intense public debate, presents an important opportunity to address these issues and design new fiduciary duties in a way that addresses their relation to existing regulatory rules as well as their interaction with general fiduciary law.

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