

The Law Is the Law (Unless and Until It Changes): Broker Does Not Owe Fiduciary Duty to Purchaser of Variable Life Insurance

President Obama recently paid a visit to Wall Street to renew his administration's efforts to revamp the nation's financial system. One of the items on the administration's agenda is to revisit (and heighten) the standard of care that a financial professional owes to his or her client. Under the administration's proposal, a retail broker would owe to a client a fiduciary duty: a higher standard of care than the current obligation only to recommend products that are suitable for a client. Against this backdrop, a recent federal court decision reminds us that federal courts exist to interpret the law as it is, not how the executive branch may want it to be.¹

The facts of *Thomas v. Metropolitan Life Insurance Company*² are unremarkable: A broker sold a variable life insurance product to a new father. As part of the process, the broker conducted a suitability analysis before recommending the product. The broker did not, however, disclose to the customer that he was receiving compensation for recommending this particular product over other products. The plaintiff alleged that this omission was actionable because the broker was acting as an investment adviser and was, therefore a fiduciary under the Investment Advisers Act of 1940 (Advisers Act). As the court analyzed the case, a fiduciary would have had an obligation to disclose such facts, but a broker would not. MetLife moved for summary judgment, arguing that the broker was covered by the "broker exception" to the Advisers Act and was not, therefore, a fiduciary. This teed up for the court the dispositive question of whether the advice the broker gave to the client was "solely incidental" to the ultimate securities transaction.

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The court granted the defendant's motion for summary judgment and held that a registered representative of a broker-dealer did not owe a fiduciary duty to a purchaser of a variable universal life insurance policy. In reaching this holding, the court analyzed in detail the broker-dealer exception to the Advisers Act.

The Advisers Act excludes brokers from the definition of investment adviser if the services provided are "solely incidental to the conduct of his business" and the broker "receives no special compensation."³ Unlike investment advisers, broker-dealers do not owe a fiduciary duty to their clients. Instead, a broker must recommend products that are suitable for a customer.⁴

The crux of the court's analysis focused on whether the services provided by the broker were excepted from the Advisers Act. The plaintiffs argued that the advice of the registered representative was not solely incidental to the conduct of his business because his advice was "'central,' 'core,' or a 'mandatory' feature of every customer sale."⁵ In addition, the plaintiff contended that conducting a suitability analysis prior to the sale of the insurance policy suggests that the investment advice was not "solely incidental to" the conduct of the broker's business.⁶

The court ultimately determined that "'solely incidental to' means 'solely attendant to' or 'solely in connection with.'"⁷ The court reasoned that "the fact that suitability evaluations are required suggests that the investment advice given by the broker to the clients ... is an example of the type of attendant advice that Congress had in mind when it exempted advice 'solely incidental to' the conduct of business as a broker or dealer."⁸ The court dismissed the plaintiff's argument that "incidental" means "minor," stating: "This meaning makes little sense ... because investment advice given by a broker would almost always play more than just a minor or insignificant role in a customer's decision to enter into a particular brokerage transaction."⁹

The court also held that the \$91 monthly premium did not constitute special compensation.¹⁰ The court noted "this argument would make potentially all brokers subject to the argument that they received 'special compensation' for their investment advice services because they are all presumably compensated by their employers for revenue-generating activities."¹¹

If the plaintiff's view were accepted, then a "good" broker – i.e., one that engages in detailed analysis before making a recommendation and discloses all relevant facts – would be more likely to be found to be an investment adviser than a "bad" broker. This would be a prime example of the adage, "No good deed goes unpunished."

This case highlights the current debate regarding the appropriate regulatory standard that should govern broker-dealers. The Obama administration notes "retail customers repose the same degree of trust in their brokers as they do in investment advisers, but the legal responsibilities of the intermediaries may not be the same."¹² The Obama administration recommends new legislation that would:

- require that broker-dealers who provide investment advice about securities to investors have the same fiduciary obligations as registered investment advisers
- provide simple and clear disclosure to investors regarding the scope of the terms of their relationships with investment professionals, and
- prohibit certain conflict of interests and sales practices that are contrary to the interests of investors.¹³

Whether this legislation is ever enacted remains to be seen. The decision in *MetLife* reaffirms that the administration's approach is not yet the law.

Pepper Points

Our view is that the court got this one right. Congress recognized that brokers give advice to clients when recommending securities, and expressly chose to exempt such behavior from the requirements of the Advisers Act. If Congress wanted brokers to owe to clients "the punctilio of an honor the most sensitive," in the words of then-Chief Judge (later, Justice) Cardozo, then it could have done so.¹⁴

Interestingly, the court recognized that full disclosure by a broker is a good thing. As the court observed: "Any salesman worth his salt can convey the reassuring

impression that his recommendations are based on his unbiased evaluation of his prospect's needs. Where the product being sold is a sophisticated financial product, as the [plaintiff's] variable life insurance policy surely was, it would seem that the need for unbiased advice – or at least for the disclosure of those things that might tend to skew the salesman's 'advice' – would seem to be every bit as great as in a conventional advisory relationship.”

But the court declined to impose on the broker a duty not imposed under current law. “The Court concludes, however, that the relevant statutory language, specifically the broker-dealer exception, precludes the application of the [Advisers Act's] fiduciary standard to the [client's] dealings with [the broker].”¹⁵

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The court did recognize, however, that the case was not a slam-dunk: “Given the stark difference, in terms of legal result, between the two plausible interpretations of 'solely incidental' that have been urged in this case, the lack of definitive appellate authority is remarkable.”¹⁶

If the Obama administration gets its way, there may never be an opportunity for an appellate court to clear this up.

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Endnotes

- 1 This decision was announced shortly after the Obama administration released a white paper on financial regulatory reform, which recommended “establish[ing] a fiduciary duty for broker-dealers offering investment advice and harmoniz[ing] the regulation of investment advisers and broker-dealers.” *Financial Regulatory Reform: A New Foundation*, Department of the Treasury (June 17, 2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.
- 2 *Thomas v. Metropolitan Life Insurance Company*, CIV-07-0121-F (W.D. Okla. Aug. 31, 2009) (hereinafter *MetLife*).
- 3 15 U.S.C. § 80b-2(a)(11)(C).
- 4 NASD Conduct Rule 2310.
- 5 *MetLife* at 8-9.
- 6 *Id.* at 12.
- 7 *Id.* at 13.
- 8 *Id.*
- 9 *Id.* at 10.
- 10 *Id.* at 17.
- 11 *Id.*
- 12 *Financial Regulatory Reform: A New Foundation*, Department of the Treasury (June 17, 2009), at 71, available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.
- 13 *Id.* at 72.
- 14 *MetLife* at 18 (quoting *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928)).
- 15 *Id.*
- 16 *Id.*

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