

SECs Merrill Lynch Rule Struck Down by the US Court of Appeals

Category : Are Your Best Interests the Same as the Financial Services Industry?

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SEC's "Merrill Lynch Rule" Struck Down by the US Court of Appeals

In a 2 to 1 decision this morning (March 30, 2007), the US Court of Appeals struck down the [US Securities and Exchange Commission's](#) rule on fee based broker accounts, which has become commonly known as the "[Merrill Lynch Rule](#)." This rule was first proposed in late 1999 and formally adopted in 2005. This rule allowed stockbrokers to act as "advisors" and to charge percent of assets fees. Prior to this rule, only investment advisors who registered with the SEC or with the states and who were regulated under the Investment Advisers Act of 1940 were permitted to do this. Under the Merrill Lynch Rule, brokers could call themselves advisers, yet remain exempt from regulation under the Investment Advisers Act, as amended. US Appeals Court Judges Judith Rogers and Brett Kavanaugh decided that the SEC had exceeded its authority in granting this exemption to stockbrokers. The ruling found no congressional intent to "support the SEC's interpretation of its authority." Whether the SEC will appeal this decision to the US Supreme Court is not clear at this point. As the decision stands today, brokerage firms would need either to convert their client wrap accounts, which currently hold several hundred billions of dollars in client assets, or be regulated by the Investment Advisers Act. Judge Merrick Garland dissented. *The Skilled Investor* has written previous articles about this exemption and about the regulation of brokers and investment advisors. (See this article on the securities industry's financial incentives, which includes an earlier discussion of the Merrill Lynch Rule: [The securities industry calls marketing and selling: "advising"](#)). You may also wish to peruse our extensive collection of articles about financial advisors in these categories: [Selecting an Advisor](#), [Regulation of Advisors](#), [Payment of Advisors](#), and [Advisor Fraud](#).) This US Appeals court decision is an important legal victory for individual investors. Numerous surveys of investors have shown that they do not understand the important legal distinctions between securities brokers and investment advisors. For almost six and one-half years, since November 4, 1999 when the SEC proposed Rule 202(a)(11) and 1.7 to regulate "fee based" and "discount" brokerage products offered by full-service broker-dealers, the SEC has just added to this ambiguity. The Merrill Lynch Rule allowed stockbrokers to call themselves "advisors," "counselors," and other similar terms that implied they were helping clients to make financial and investment decisions in their clients' best interests. In fact, brokers have had no legal obligation to act in the best interests of their clients. Instead, securities laws only required them to sell "suitable" financial and investment products to the public. The definition of a "suitable" investment is vague at best. The full-service brokerage industry wanted the ability to market themselves as advisors without the legal obligations that the Investment Advisor's Act entailed, and the SEC aided this effort for years. These legal proceedings were prompted when the SEC formally adopted its "Merrill Lynch Rule" in 2005. The SEC then was sued by the [Financial Planning Association](#) and by the [Consumer Federation of America](#). [This link will take you to a press statement from the FPA about this court decision](#). (Note that the parent company of *The Skilled Investor*, Lawrence Russell and Company, is a registered investment adviser in the wonderful state of California. We have no relationship with the FPA, the CFA, or any other party mentioned in this article.)