Remarks at the National Association of Plan Advisors D.C. Fly-In Forum

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Thank you, Steve [Dimitriou], for that kind introduction. I am delighted to be here. The National Association of Plan Advisors' leadership in the retirement industry deserves praise. Preparing for retirement is an issue that affects every American, so you provide an essential service.

Before proceeding, I must, as always, provide the standard disclaimer that the views I express today are my own, and do not necessarily reflect the views of the Commission or my fellow Commissioners.

I am going to focus today on an issue that has been prominently and highly debated over the last decade – the appropriate standard of care for those who provide investment advice to retail investors. As demonstrated by the endurance and passion of arguments on all sides, this question is not just really hard to answer. It is really, really, really hard – with three "reallys". I want to be clear that I have not yet reached a conclusion on whether or what new obligations should be imposed on financial services professionals. But, I would like to preview how I am approaching the issue. Time permitting, I would be happy to answer questions.

To provide some context for the standard of care issue, or, as some call it, the uniform fiduciary duty debate, we need to look at where we are and how we got here. Today, both broker-dealers and investment advisers provide investment advice on an ongoing basis. But to rewind a bit, the dividing line between services provided by broker-dealers and investment advisers historically was distinct. Broker-dealers executed transactions for a commission, and investment advisers provided investment recommendations and managed assets for a fee. The line began to blur in the 1990s, with the growth in fee-based brokerage accounts that provided traditional brokerage services but charged customers a fixed fee or a fee based on assets in the account. The Commission's response to this shifting market dynamic included adopting a rule in 2005 to address, among other things, the application of the Investment Advisers Act of 1940 ("Advisers Act") to broker-dealers offering their customers full service brokerage, including advice, for a fee instead of traditional commissions.[1] However, as a result of a decision by the U.S. Court of Appeals for the D.C. Circuit, that rule was vacated.[2] The business practices of broker-dealers and investment advisers – and in particular, their approach to providing advice to clients –continued to evolve.

Fast forward to the present. The blurry line between services provided by broker-dealers and investment advisers has led to a call for regulators to impose a so-called "uniform fiduciary duty," such that a client being given investment advice would receive the same standard of care regardless of whether the advice comes from a broker-dealer or an investment adviser. Perhaps the most famous, or some might say infamous, effort to create a uniform fiduciary duty was the Department of Labor's October 2010 proposal to broaden its definition of a "fiduciary"[3], which ultimately was rescinded. Thankfully, the Commission has made no such rush to judgment.

Investors are Confused

In 2006, the Commission retained RAND Corporation to conduct a study (the "RAND Study") to: (1) examine broker-dealers' and investment advisers' practices in marketing and providing financial products and services to individual investors, and (2) evaluate investors' understanding of the differences between broker-dealers and investment advisers' financial products and services and their duties and obligations.[4] The study concluded that investors were confused.[5] But, "[d]espite their apparent confusion about titles, duties, and fees, investors expressed high levels of satisfaction with the services they receive from their own financial service providers."[6]

The Dodd-Frank Act mandated an additional study of standards of care, this time to be conducted at the Commission.[7] In particular, the Commission was required to evaluate: (1) the effectiveness of existing legal or regulatory standards of care for providing personalized investment advice and recommendations about securities to retail customers, and (2) whether there are legal or regulatory gaps or shortcomings in the protection of retail customers relating to the standards of care for providing such advice and recommendations that should be addressed by rule or statute. Notably, Dodd-Frank also granted the Commission discretionary authority to impose a uniform standard of conduct for broker-dealers and investment advisers.[8]

In January 2011, the Commission submitted to Congress the study required by the Dodd-Frank Act (the "SEC Study"). In it, the Commission staff recommended that the Commission adopt and implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers, because "retail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities."[9]

One can call into question the rigor of the SEC Study and whether the recommendations were fully supported,[10] but based on it and the RAND study, I think we can confidently say retail investors are confused and do not understand the differences between the duties of broker-dealers and investment advisers. However – and this is a big however – it is not clear that changes in the regulations applicable to broker-dealers and investment advisers are necessary, including the adoption of a uniform fiduciary duty. Before adopting any new rules or rule amendments, the Commission has to consider "What are the marginal benefits and what are the marginal costs?" To do a proper analysis, we must first look at the current regulatory landscape.

The Standard of Care Is Not Always the Same

Broker-dealers and investment advisers are subject to different regulatory regimes, each established over 70 years ago. An investment adviser is a fiduciary, with a duty to serve the best interests of its clients, including an obligation not to subordinate clients' interests to its own. As a fiduciary, an investment adviser owes a duty of loyalty and care to its clients. In contrast, a broker-dealer generally is not considered a fiduciary. Broker-dealers are required to deal fairly with their customers, pursuant to SEC and self-regulatory organization ("SRO") rules. Important aspects of a broker-dealer's duty of fair dealing are the suitability obligation, which requires a broker-dealer to make recommendations that are consistent with the investment profile of its customer, and the requirement to provide best execution for client trades. Broker-dealers are also required to disclose material conflicts of interest to their customers when making a recommendation.

In the ongoing debate about the need to create a uniform fiduciary duty for broker-dealers and investment advisers, it is sometimes asserted that a broker-dealer's duties have less "teeth" than an investment adviser's. That claim overlooks the robust regulatory scrutiny to which broker-dealers are subject. From January 1, 2013 through June 30, 2014, approximately 96 actions brought by FINRA against broker-dealers and associated persons included violations of suitability rules. As of this September, these actions have resulted in a total of approximately $7.1 million in fines assessed against 25 firms and 46 registered representatives. In addition, 20 registered representatives were barred, 53 were suspended, and one firm was expelled. Close to $4.8 million in restitution was ordered to be paid to investors.[11]

Despite Confusion and Different Standards of Care, Is SEC Action Warranted?

As I said is true for any rule we consider, we need to do a cost-benefit analysis before acting. The Commission took an important step in 2013 by requesting data and information about various approaches to the standard of care issue.[12] We have received many comments, which the Commission will use to assess whether to proceed with a rulemaking. I want to highlight a few of the significant costs and benefits. Let's start with the benefits side of the ledger. I am not aware of any evidence that retail investors are systemically being harmed or disadvantaged under one regulatory regime as compared to the other. In fact, the SEC Study found that "[i]nvestment advisers and broker-dealers are subject to extensive regulation and oversight designed to protect clients and customers, whether retail or other. Both regulatory regimes require investment advisers and broker-dealers to adhere to high standards of conduct in their interactions with retail investors, which are intended to encourage both broker-dealers and investment advisers to act in the interests of their investors and minimize conflicts of interests when providing personalized investment advice or recommendations."[13] Therefore, a uniform fiduciary standard of care may not even result in a client getting different investment advice than they receive today.

Furthermore, it is not clear that a uniform fiduciary duty would eliminate or even substantially ameliorate investor confusion. The standard of conduct applicable to broker-dealers and investment advisers is not the only distinction between the regulatory regimes. There are, among other things, differences in the advertising rules, supervisory requirements, licensing and registration of firms, and the books and records requirements. Given all of these, even if the Commission were to adopt a uniform fiduciary standard, it is quite likely that investor confusion would continue. For this reason, the Commission staff's recommendation regarding a uniform fiduciary standard of care was accompanied by a recommendation that the Commission consider harmonizing the regulatory requirements of broker-dealers and investment advisers in situations when they are performing the same or substantially similar functions, taking into account the best elements of each regulatory regime.[14] Interestingly, the possibility of a broad regulatory harmonization, which would go beyond a standard of care, generally is not part of the public conversation, despite the fact that we asked questions about it in our 2013 request for data and information.[15] That topic needs to be fully part of the discourse, or our cost-benefit analysis will be wholly incomplete.

With respect to costs, we need to recognize that a uniform fiduciary duty actually could harm retail investors. Members of Congress on both sides of the aisle have voiced concerns that applying a fiduciary standard of care to broker-dealers could restrict middle-class families' and minority communities' access to professional financial advice by making retirement advice unaffordable.[16] Twenty-nine members of the Congressional Black Caucus, along with members of the Congressional Hispanic Caucus and a member of the Congressional Asian Pacific American Caucus wrote to the Department of Labor in anticipation of its reproposal of the definition of a "fiduciary," expressing their worry "that a more restrictive definition of fiduciary would add yet another barrier to accessing qualified retirement planning services."[17] The letter went on to say that "any attempt to change the existing regulatory structure governing the fiduciary standard should be executed carefully, prudently, and in conjunction with the SEC to avoid uncertainty and disruption in the marketplace."[18] I share these serious concerns about investors potentially having limited financial advisory options or being locked out from receiving investment advice altogether.

There is a real-world example now playing out that further reinforces why we should exercise extreme caution as we consider any changes to standards of care. In 2013, the United Kingdom ("UK") introduced the Retail Distribution Review ("RDR"), which was designed to promote transparency in the financial advice industry. The RDR bans advisers from taking a commission for selling products and requires that all fees, paid only by clients, had to be agreed upon in advance. Prior to the RDR, advisers did not charge clients for advice, but instead earned commissions from asset managers for selling their products. A survey conducted prior to the implementation of the RDR suggested that advisers would be likely to de-prioritize a large proportion of their smaller customer accounts as they moved upmarket to defend profit margins.[19] The survey estimated that the RDR would create a significant post-RDR "advice gap" of up to 5.5 million (about 11% of UK adults) disenfranchised customers who would either choose to cease using financial advisers or

otherwise would not have access to them.[20] It turns out the effects were even worse than predicted. A recent article, written after implementation of the RDR, reported that the survey significantly underestimated the impact – by about 50% – and that there are currently 11 million people in the UK managing their own portfolios that say the services offered by financial advisers are too expensive.[21] Researchers found substantial negative effects on competition, with a reduction of more than 44% in bank advisers and 20% in independent financial advisers after the RDR was implemented.[22]

I indicated at the outset that I have not made a decision about whether I would or would not support a uniform fiduciary duty. But, it is important to note that based on the data available to me now, the potential benefits seems elusive and the potential costs sky-high. Therefore, we need to take a measured and deliberative approach to the standard of care issue. Just such an approach has been suggested in a bill introduced by Congresswoman Ann Wagner and passed by the U.S. House of Representatives last fall. The bill, entitled the Retail Investor Protection Act, would prohibit the Commission from promulgating a uniform fiduciary standard before the Commission has ascertained: (1) if retail customers are systemically harmed or disadvantaged owing to the operation of brokers or dealers under different standards of conduct than those that apply to investment advisers under the Investment Advisers Act, and (2) whether adoption of a uniform fiduciary duty would adversely impact retail investor access or availability to personalized investment advice and recommendations.[23] The bill also would require the Commission to publish formal findings that such rule would reduce retail customer confusion about the standards of conduct applicable to broker-dealers and investment advisers.[24] Needless to say, the Commission should always consider the cause of a problem and the potential impact and costs of potential solutions before adopting any rule or regulation.

Investor Testing of Disclosure-Based Solutions

If our concern is that retail investors are confused about the duties their broker-dealers and investment advisers are subject to, the Commission should consider whether that confusion could be resolved through means other than a uniform fiduciary standard of care. For example, the Commission could consider enhancements to our disclosure regime. Before I elaborate, I must state the obvious. It is very likely that our current disclosure requirements play a big part in causing the very problem we are trying to solve.

Recently, my personal financial adviser switched brokerage firms. I decided to retain his services, and followed him to the new firm where, as part of the account opening process, I received a thick packet of disclosure documents. Let's be realistic – there was no way I was going to read through that stack of paper. Here I am, an SEC Commissioner and financial economist, and the required disclosures were essentially worthless. It is no wonder retail investors are confused when it comes to their financial professionals and the standard of care for the advice they are receiving.

The problem, however, is not limited to broker-dealer disclosures to retail clients. Corporate and variable annuity investors face similar disclosure overload. Our regulatory regime at its core is disclosure-based, and yet our disclosure requirements are failing investors. The problem is exacerbated by the influence of special interests on both Congress and the Commission. Every time there is a financial crisis or scandal, groups line up with their requests for additional, at best questionable, disclosures. Some of the more recent examples of this were Congress's inclusion in the Dodd-Frank Act of requirements for companies to disclose their median pay ratio and information about the use of so-called "conflict minerals." Both of these initiatives are unrelated to the financial crisis, and just further bury investors with useless and, in some cases, misleading information. An overhaul of disclosure requirements is long overdue.

To come back to the issue of standards of care, I believe there is a "fix" we should explore that could achieve the goal of improving investor knowledge of what can and should be expected of their broker-dealer and investment adviser, without introducing the significant costs I referenced earlier. We should consider the value of a concise disclosure document for broker-dealers and investment advisers. As to what this document would look like and what information it would contain, the Commission should, in reliance on its authority under Section 912 of the Dodd-Frank Act, undertake a temporary testing program to determine what information investors find important and useful in selecting a financial adviser. The Commission could

then test formats in which the information can be presented, and the effect on investor comprehension of the information. In this way, we would be able to propose a disclosure document that is firmly based on investor input, which is the best and most sensible way to solve the investor confusion issue.

Possible examples the Commission could use in devising its investor testing include: (1) a summary disclosure document similar to the mutual fund summary prospectus;[25] (2) a disclosure statement for retail investors at or before commencing a business relationship, as described in FINRA's 2010 concept proposal;[26] and (3) the table of information included in the Truth in Lending disclosure requirements for credit card applications and solicitations.[27]

Conclusion

I would like to make one final point. Much has been made about a need for the Commission to act on a uniform fiduciary standard before the Department of Labor reproposes its definition of "fiduciary," or at the very least adopt a uniform fiduciary duty after the Labor Department does. To be absolutely clear about my position on that topic – no. We should not act just to respond to the potential or eventual actions of another body. The Commission is an independent agency, and, as I never get tired of saying, should act only when we have all the information we need and when doing so will promote our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. That includes fully understanding the nature of the issue at hand, the cause giving rise to the issue, and the possible costs and benefits of all potential solutions.

Thank you for your attention. And, thank you again for all that you do to help Americans plan for retirement. I am happy to answer any questions you may have.

[1] *See* Certain Broker-Dealers Deemed Not To Be Investment Advisers, Investment Advisers Act Release No. 2426 (Sept. 12, 2005), *available at* http://www.sec.gov/rules/final/34-52407fr.pdf.

[2] *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

[3] *See* Definition of the Term "Fiduciary," 75 F.R. 65263 (Oct. 22, 2010), *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=24328&AgencyId=8&DocumentType=1. After receiving numerous comment letters objecting to the proposal, the Department of Labor announced in September 2011 that it would re-propose the rule. *See* US Labor Department's EBSA to Re-Propose Rule on Definition of a Fiduciary, Release No. 11-1382-NAT (Sept. 19, 2011), *available at* http://www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html.

[4] *See* Angela A. Hung et al., *RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008) ("RAND Report"), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

[5] *Id.* at 112-113.

[6] *Id.* at 118.

[7] *See* Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) ("Dodd-Frank Act"), *available at* http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

[8] Section 913(f) of the Dodd-Frank Act states that the "Commission *may* commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to such retail customers." [*emphasis added*]

[9] *See* SEC Staff, *Study on Investment Advisers and Broker-Dealers* (Jan. 2011) at 165, *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf.

[10] *See* Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes: Statement Regarding Study On Investment Advisers and Broker-Dealers (Jan. 21, 2011), *available at* http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

[11] These statistics were provided by FINRA. The sanction data reflects the entirety of sanctions issued in the actions, some of which may include violations of other rules and regulations in addition to violations of FINRA's suitability rules.

[12] Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013), *available at* http://www.sec.gov/rules/other/2013/34-69013.pdf.

[13] *See* SEC Staff, *Study on Investment Advisers and Broker-Dealers* (Jan. 2011) at 102.

[14] *See id.* at 165-66.

[15] *See* Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013).

[16] *See, e.g.*, Letter from Congresswoman Frederica S. Wilson *et al.*, to Secretary Seth Harris (June 14, 2013) ("Letter to Harris"), *available at* http://www.financialservices.org/uploadedFiles/FSI-Letter-to-DOL-on-Fiduciary-Redefinition-2013.pdf; Letter from Congressman Mike Fitzpatrick *et al.*, to Secretary Hilda L. Solis (July 6, 2011), *available at* http://www.dol.gov/ebsa/pdf/1210-AB32-PH0101.pdf.

[17] *See* Letter to Harris.

[18] *Id.*

[19] *See* Deloitte, *Bridging the Advice Gap -- Delivering Investment Products in a Post-RDR World* (Nov. 2012), *available at* https://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Industries/Financial%20Services/uk-fs-bridging-the-advice-gap.pdf.

[20] *See* id.

[21] *See* Emma Wall, *10 Million Find Advice Too Expensive* (Aug. 28, 2014), *available at* http://www.morningstar.co.uk/uk/news/128424/PrintArticle.aspx.

[22] *See* Deloitte, *Recognising RDR Reality -- The Need to Challenge Planning Assumptions* (July 2013), *available at* http://www.deloitte.com/view/en_GB/uk/industries/financial-services/issues-trends/retail-distribution-review/794d59a825daf310VgnVCM3000003456f70aRCRD.htm.

[23] Retail Investor Protection Act, H.R. 2374 (Oct. 29, 2013), *available at* https://beta.congress.gov/113/bills/hr2374/BILLS-113hr2374eh.pdf.

[24] *Id.*

[25] Mutual funds have the option, but are not required, to provide investors with a summary prospectus. *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009), *available at* http://www.sec.gov/rules/final/2009/33-8998.pdf. Commission staff recently estimated that well in excess of 80% of mutual funds offer investors summary prospectuses, which often provide clear and concise disclosure. *See* U.S. Securities and Exchange Commission, Division of Investment Management, *Guidance Update No. 2014-08* (June 2014), *available at* http://www.sec.gov/investment/im-guidance-2014-08.pdf.

[26] *See* Disclosure of Services, Conflicts and Duties, FINRA Regulatory Notice 10-54 (Oct. 2010), *available at* https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf.

[27] *See* 12 C.F.R. § 226. The FDIC conducted consumer testing in developing the credit card disclosures. *See* Truth in Lending, 72 F.R. 5244 (Jan. 29, 2009) at Section III.C, *available at* http://www.gpo.gov/fdsys/pkg/FR-2009-01-29/pdf/E8-31185.pdf.

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