Public Statement

Statement on Final Rules Governing Investment Advice

Commissioner Robert J. Jackson Jr.

June 5, 2019

Our Nation is facing a savings crisis. Many young workers are unable to save at all; half of America's retirees have saved less than $65,000 and face the terrifying prospect of running out of money in retirement.[1] Every time those Americans seek help from financial professionals, they're asked to trust someone whose interests can be contrary to their own. And when that conflict leads to bad advice, investors suffer costs that American savers simply cannot afford.

I believe that the SEC's most crucial task is to protect investors from the dangers this basic economic reality presents. Since I've been on the Commission, I have fought to do just that. So my hope was that the rules we announced today would significantly raise the standard for investment advice in this country. I hoped to join my colleagues in announcing that the Nation's investor protection agency has left no doubt that, in America, investors come first.

Sadly, I cannot say that. Rather than requiring Wall Street to put investors first, today's rules retain a muddled standard that exposes millions of Americans to the costs of conflicted advice. Even worse, contrary to what Americans have heard for a generation, the Commission today concludes that investment advisers are not true fiduciaries. Today's actions fail to arm Americans with the tools they need to survive the Nation's retirement crisis. Accordingly, I respectfully dissent.

I. Failing to Put Investors First

Today's meeting is about one question: When American investors planning their financial futures seek help from investment professionals, do those professionals have to *put investor interests first*? Today the Commission answers: "no." In other words, whether an American family uses an advisor or a broker to grapple with their financial future, today's rules simply do not require investor interests to come first.

As to investment advisers, the final guidance the majority approves today removes language from last year's proposal stating that the law "requires an investment adviser to put its client's interests first."[2] The guidance suggests that a careful reading of decades-old cases reveals that we were wrong last year to say that this is the law. I disagree.[3] Thousands of advisers who have taken pride in putting clients first for decades will be surprised to learn that, all along, the SEC has had lower expectations for their work. [4]

The law does not compel the conclusion my colleagues reach today; instead, the Commission is wrapping a policy choice in legalese.[5] I do not think the best way for the SEC to make policy decisions affecting millions of American investors is to pursue new readings of old cases. Instead, we should ask investors what *their* expectations are—and what common sense demands. I think we can learn a lot more from what investors are

being told than what lawyers and lobbyists say to us. Today's guidance claims that we "lack data to identify which . . . advisers currently understand their fiduciary duty to require something different" than the standard we're announcing, but that's incorrect.[6] We've been requiring advisers to disclose what they tell investors about their duties for years.

So my Office extracted the text from more than half a million brochures that advisors gave investors. And the evidence is telling. Of the firms that affirmatively described their fiduciary duty to investors last year, those with 89% of assets under management told the American public that they put investor interests first.[7] Only a small sliver of the market uses the legalese in today's interpretation when describing the law to the investing public. So we know from the data that most investors are being told that their interests come first. But that raises an important concern: what if the language that advisers use to describe their conduct is not, in fact, indicative of the quality of advice investors actually receive?

To test this possibility, my Office examined whether the language advisers use predicts how often investors get conflicted advice. If language[8] doesn't matter—that is, if advisers behave the same way regardless of what they tell investors—we should see no correlation between that language and conflicted advice. But that's not the case. Instead, in analysis released by my Office today, we show that advisers who use the language in today's release are much more likely to offer conflicted advice.[9] And a well-known study shows that conflicted advice is the kind that leads to fraud that can hurt investors.[10] Although I called last year for us to "survey market participants, from the largest institutions to the smallest retail investors, about whether and how they understand their legal rights and responsibilities," none of these facts about what advisers tell investors are considered in today's release.[11]

As to brokers, today's rule, like the proposal, fails to require that investor interests come first. Congress expressly authorized us to take that step in Dodd-Frank—authority we should have used today.[12] Instead, the core standard of conduct set forth in Regulation Best Interest remains far too ambiguous about a question on which there should be no confusion. As a result, conflicts will continue to taint the advice American investors receive from brokers.

Moreover, the rule relies on a weak mix of measures that are unlikely to make much difference in improving the advice ordinary Americans receive from brokers. The rule does not "defin[e] . . . the term 'Best Interest,'" and in fact goes out of its way to say that it doesn't "require broker-dealers to recommend [one] 'best' product." [13] Moreover, troubling broker compensation practices that put investors at risk are addressed when they are "based on the sales of specific securities within a limited period of time," or "create high-pressure situations." These restrictions merely mimic those in longstanding FINRA proposals, and I cannot see why our rules should permit pay practices that create *any* pressure for brokers to harm investors. [14]

The final rule also substantially weakens even the proposal's limited requirement that firms mitigate the conflicts their brokers face, allowing the conflicts to be resolved through disclosure alone.[15] On Form CRS, the final rule invites industry to use new "flexibility" to "use their own wording" in describing themselves to investors, and expressly declines to require firms to disclose every material conflict. The majority also misses an opportunity to clarify crucial differences between brokers and advisers in its interpretation of what it means for advice to be "solely incidental". I worry that the new interpretation simply enshrines into law the blurred lines between two very different business models.

So the final Regulation Best Interest has, in these instances and many more, lowered the bar even from the standards we set in last year's proposal. But more fundamentally, I can't vote to support Regulation Best Interest for the same reason I can't vote for our guidance on investment advisers: neither requires Wall Street to put investor interests first. And for those who wonder whether language matters, the most compelling evidence comes from the finance industry's own advocates. They've argued in comments to us that "the assertion that an investment adviser must put clients' interest 'first' is very different from saying that they may not 'subordinate' or 'subrogate' clients' interests."[16]

I agree. Because today's rules fail to require the firms entrusted with Americans' savings to put investor interests first, I cannot vote to adopt them.

II. Failing to Analyze the Costs of our Choices

Changes of generational scale and scope like these deserve careful attention to the costs and benefits of the policy choices we're making. When we proposed these rules last year, I urged the Staff to examine the economic implications of our decisions in detail.[17] Indeed, the analysis in our proposal was so slight that we received a remarkable letter from ten former Chief Economists of the Commission urging us to "do better on this important rule."[18] Unfortunately, today's economic analysis offers no new data to support today's rules—and ignores important new evidence how those choices affect investors.

Take, for example, our decision not to use the authority Congress gave us in this area. The economic analysis of that choice consists of conclusory statements regarding possible effects of taking that step. We are told, for example, that financial professionals would face "additional compliance costs," and would "likely pass on the . . . increase in the costs to their clients." An equally possible outcome, the analysis suggests, is that "the new fiduciary standard may result in a different menu of choices that allows retail customers . . . to access investment advice in a more cost efficient manner."[19]

But the latter statement is much more than a mere possibility. *It happened*. Important recent research from scholars at the University of Chicago and Northwestern uses several States' decisions to apply fiduciary standards to broker-dealers, combined with transaction-level evidence from a major financial services provider, to examine the effect of imposing fiduciary obligations on brokers.[20] The answer provides concrete evidence of the costs we've imposed on investors today by failing to use the authority Congress gave us in Dodd-Frank.

Two things happened in States that extended fiduciary obligations to brokers. First, those brokers provided a better menu of investment options to clients.[21] Second, brokers sold those investors fewer variable annuities relative to fixed indexed annuities. And because variable annuities can be costly, the study shows that investors in those States saved significant sums. Indeed, across States that made that choice—including Alabama, Georgia, Michigan, New Hampshire, South Carolina, Tennessee, Texas, Nevada, Virginia, and Vermont—investors saved 51 basis points each year by getting better advice:

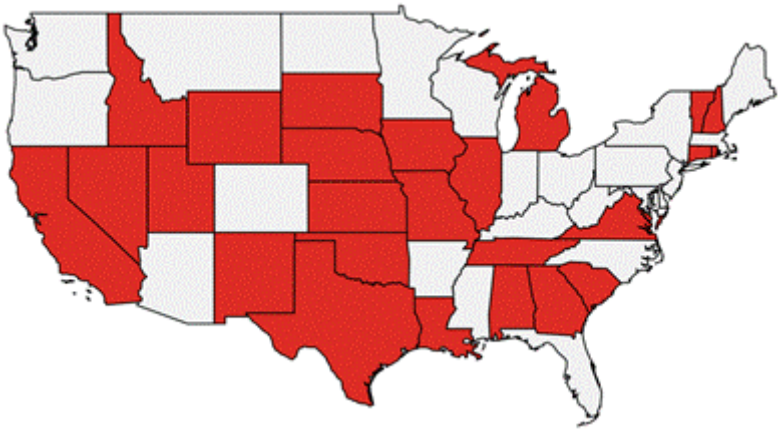

Figure 1. States Benefiting From Fiduciary Obligations on Brokers[22]

Half a percentage point each year might not sound like much. But to Americans facing a savings crisis, those savings could make all the difference. It's true that this study considers just one investment choice in just those States that decided to impose fiduciary obligations on their brokers.[23] But I agree with those who've summarized the study this way: "A standard that leads brokers to shift all of their clients from bad expensive [products] to good cheap ones seems straightforwardly positive."[24]

Any analysis of today's choice not to follow the lead of these States, and Congress's direction in Dodd-Frank, should consider this evidence in depth. Instead, the release relegates this study to a single unpersuasive footnote.[25] I worry that observers will argue that we have not taken this evidence seriously. And giving theoretical possibilities equal weight to facts is a flimsy basis for making policy decisions of generational importance for investors.[26]

III. The Fate of State Investor Protections

Those who, like me, are disappointed by our failure today to protect America's savers from conflicted advice may take comfort in the fact that so many States have imposed true fiduciary obligations on financial professions who do business within their borders. Those States have, in the vision of Justice Brandeis, provided essential experiments for the future of these debates.[27]

And early evidence suggests that these experiments are working. The study mentioned above shows that, in so many States, imposing a real fiduciary standard has saved ordinary investors real money. A family that sets aside $100,000 in Nevada using unconflicted advice can expect to have $55,000 more in their pocket after 20 years than a family without that opportunity in Wisconsin. That's money that can and should go to Americans' education, retirement, and health care instead of conflicted advisors.

Unless and until the Commission promulgates a standard that puts investors first, it is crucial that the States remain free to do exactly that. So I am deeply discouraged that our release is unclear about whether, and how, today's rule will displace carefully constructed and hard-won state laws.[28] We can and should say unequivocally that today's release sets a federal floor, not a ceiling, for investor protection.[29] Our failure to do so invites extensive and expensive litigation over the scope of the rule—and its effects on nascent state regulation.

* * * *

Today, the agency charged with protecting American savers has failed to force Wall Street to put investors first. But Regulation Best Interest is only the beginning.[30] And, as those of you who know me understand, I am an optimist. I firmly believe that one day soon—with the support of many of you in this room—the Commission will do more.

In the meantime, I call on all of you who have been so crucial to this effort to keep fighting. Encourage investors to seek out true fiduciary advice from financial professionals who have chosen to hold themselves to higher standards than those we've set today.[31] Keep pushing for meaningful protections in the States who choose to give their citizens the best chance for a safe retirement. And, most importantly, do not stop the critical work of advocating for the financial security of all Americans.

---

[1] *See* Vanguard, How Americans Save 44 (2018) (providing evidence that more than 20% of American workers under 45 do not contribute to their retirement plans at all); *see also id.* (noting that the median account balance in Vanguard defined-contribution accounts for savers 65 and over was $64,811 in 2018).

[2] *Compare* Securities and Exchange Commission, Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-4889 (proposed April 18, 2018) (to be codified at 17 C.F.R. pt. 275), at 15 [Proposed Interpretation] *with* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248, 17 C.F.R. pt. 275 (June 5, 2019) [Final Interpretation].

[3] For every selective citation in support of a narrow interpretation of adviser duties, there is a citation for the proposition that the law requires that investors come first. *Compare* Letter to Brent J. Fields, Sec'y, Securities and Exchange Commission from Ropes & Gray, LLP (Aug. 7, 2018), at 3 & n.10 (citing *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180 (1963), and concluding that "a disclosure-based fiduciary duty" "embodies the highest ethical standards" required by that opinion) *with Capital Gains*, 375 U.S. at 186 (Goldberg, J.) (drawing the "highest ethical standards" language from another Justice Goldberg opinion, *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 366 (1963), concluding that the securities laws impose a notice and hearing requirement for stock exchange action—hardly a setting for endorsement of disclosure alone as a path to the "highest ethical standards").

[4] *See, e.g.*, BlackRock, About Us: History (last accessed June 3, 2019) ("BlackRock began in 1988 with eight people in a single room who shared a determination to put clients' needs and interests first."); Roger W. Ferguson Jr., President and Chief Executive Officer, *TIAA: 100 Years of Putting Clients First* ("Since Andrew Carnegie founded us in 1918, we have put our clients first."). It will also be surprising to those Staff of the Commission, such as the former Director of our Office of Compliance, Inspections, and Examinations, who served for decades with little doubt that the law requires advisers to put investors first. *See, e.g.*, Director of

the Office of Compliance, Inspections and Examinations, Securities and Exchange Commission, *Speech by SEC Staff: Fiduciary Duty—Return to First Principles* (Feb. 27, 2006) ("I would suggest that an adviser, as that trustworthy fiduciary, has five major responsibilities when it comes to clients. *They are: 1. To put clients' interests first*." (emphasis added)).

[5] In addition to concluding that investment advisors need not put investor interests first, the interpretation takes a troubling turn toward a disclosure-only regime for investment advisers. *See* Final Interpretation, *supra* note 2, at 39 ("We disagree that this Final Interpretation includes a requirement to eliminate conflicts of interest . . . elimination of a conflict is one method of addressing that conflict; when appropriate, advisers may also address the conflict by providing full and fair disclosure such that a client can provide informed consent to the conflict.").

[6] *Id.* at 29-30. In fact, thousands of investment advisers regularly file Form ADVs with us specifying that they understand the law to require them to put investors first. *See, e.g.*, TIAA-Cref Investment Management LLC, Investment Adviser Public Disclosure, Investment Adviser Firm Summary ("TIAA-Cref Investment Management] is committed to putting the interests of its clients first."). The interpretation's failure to analyze this text is especially puzzling given that the economic analysis issued today in connection with Regulation Best Interest relies on these data for other purposes. Securities and Exchange Commission, Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031, 17 C.F.R. pt. 240 (June 5, 2019) [Final Rule], at 413-414.

[7] We extracted the text from Form ADV Part II brochures, using regular expressions to examine the first mention of the word "fiduciary." We then extracted the subsequent 500 characters after that word to see how firms describe their fiduciary duties to their clients. We looked for patterns matching language involving putting clients' interests first, contrasting those with several manifestations of language avoiding the subordination of clients' interests to those of advisers. For further detail on this analysis, please see the Online Appendix issued by my Office in connection with this statement.

[8] It may be, of course, that advisers who file Form ADVs stating their commitment to put investors first carefully disclaim that statement elsewhere in their disclosures, *see, e.g.*, Letter to Brent J. Fields, *supra* note 3. If so, this seems like a reason for the Commission to tighten our rules governing such disclaimers—rather than expanding advisers' ability to "shape" the application of their duties to investors "by agreement." Final Interpretation, *supra* note 2 at 11 & n.31 (importantly, discouraging disclaimers of this type in the retail context —but leaving their use with institutional clients like pension funds to the "particular facts and circumstances").

[9] As explained in our Online Appendix, we run cross-sectional regressions with year fixed effects, where the dependent variable is a measure of conflicts of interest, following William Christopher Gerken & Stephen G. Dimmock, *Predicting Fraud by Investment Managers*, 105 J. Fin. Econ. 105 (2011). We include year fixed effects because we are interested in differences among firms and the language they choose. We control for a variety of firm characteristics, including size (which we proxy for using assets under management and average account size), past instances of misconduct (that is, disclosures of fraud, regulatory, civil or criminal violations), as well as other potential conflicts (soft dollars, referral fees, and the like). As noted in the Online Appendix, our results are robust to using a stricter definition of conflicted advice, which based upon only whether the firm recommends products in which they have a proprietary (ownership) or sales interest.

[10] *Id*. at 1 ("We find that disclosures related to past regulatory and legal violations, conflicts of interest, and monitoring have significant power to predict fraud. Avoiding the 5% of firms with the highest ex ante predicted fraud risk [as predicted from the contents of their disclosures on Form ADV] would allow an investor to avoid . . . over 40% of total dollar losses from fraud."). Some have suggested that, notwithstanding advisers' public commitment to put clients' interests first, advisers have long understood that the law does not require that result. *Compare, e.g.*, TIAA-Cref, *supra* note 4, *with* Letter to Brent J. Fields, *supra* note 3, at 4 & n.14 ("[I]n our numerous dealings with the Commission's inspection and enforcement staff, absent a credible assertion of bad faith, advance and specific disclosure of an activity has consistently been accepted as a defense against breach of fiduciary duty claims arising from such activity, even when the activity was not in the best interests of the client."). If this were true, we would expect to see no correlation between the linguistic formulation used and the amount of conflicted advice provided. As noted above, this is not the result we observe.

[11] Securities and Exchange Commission, Statement of Commissioner Robert J. Jackson, Jr. on Proposed Rulemakings Relating to IABD Standards of Conduct (April 18, 2018).

[12] 15 U.S.C. § 80b-11(g) ("The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers . . . shall be to act in the best interest of the customer *without regard to the financial or other interest of the broker*" (emphasis added)).

[13] Final Rule, *supra* note 6, at 35, 286.

[14] *Compare id*. at 352 ("The requirement is designed to eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities and specific types of securities within a limited period of time.") *with id.* at 353 ("[T]his requirement is not designed to prohibit broker-dealers from providing such incentives, provided that they do not create high-pressure situations to sell a specifically identified type of security (e.g., stocks of a particular sector or bonds with a specific credit rating) within a limited period of time") *and* Financial Industry Regulatory Authority, Regulatory Notice 16-29 (August 2016) (describing a three-year old FINRA proposal that would similarly require non-cash compensation arrangements to "not be based on conditions that would encourage [a broker] to recommend particular securities or categories of securities," and would "not permit product-specific internal sales contests").

[15] *Compare* Securities and Exchange Commission, Regulation Best Interest, Release No. 34-83602 (proposed April 18, 2018) (to be codified at 17 C.F.R. pt. 240) [Proposed Rule], at 176 ("[T]he Commission proposes to require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to identify *and disclose and mitigate, or eliminate*, material conflicts of interest arising from financial incentives" (emphasis added)) *with* Final Rule, *supra* note 6, at 44 ("[R]ather than requiring mitigation of all firm-level financial incentives, we have determined to refine our approach by generally allowing firm-level conflicts to be addressed through disclosure.").

[16] Letter to Brent J. Fields, Sec'y, Securities and Exchange Commission from the Asset Management Group of the Securities Industry and Financial Markets Association (Aug. 7, 2018), at 5.

[17] *See* Jackson, *supra* note 11 ("[T]he cost-benefit analysis in these proposals do not reflect a serious attempt to evaluate the effects of our choices on real-world investors.").

[18] Letter to Brent J. Fields, Sec'y, Securities and Exchange Commission from Former Chief Economist Charles Cox et al. (Feb. 6, 2019) (citing Office of the General Counsel, Securities and Exchange Commission, Memorandum to the Staff of the Rulewriting Divisions and Offices (March 16, 2012) ("Recent court decisions . . . have raised questions about . . . the Commission's economic analysis in its rulemaking, including . . . identifying and evaluating reasonable alternatives to the proposed regulatory approach" (citing *Chamber of Commerce* v. *SEC*, 412 F.3d 133, 144-5 (D.C. Cir. 2005))).

[19] Final Rule, *supra* note 6, at 649.

[20] Vivek Bhattacharya, Gaston Illanes & Manisha Padi, *Fiduciary Duty and the Market for Financial Advice* (NBER Working Paper No. 25861) (May 2019).

[21] *See id.* at 22, 23 & tbl.IV (using Morningstar ratings as a proxy for menu quality and providing causal evidence of the effects of imposing fiduciary obligations on the choices brokers offer to investors); *id.* at 25 & tbl.V (providing, in the first specification, a point estimate of 51 basis points saved by investors in treatment States, assuming optimal portfolio choice).

[22] As noted in Figure 1, the complete list of States benefiting from applying fiduciary obligations to brokers includes Alabama, California, Connecticut, Georgia, Iowa, Idaho, Illinois, Kansas, Louisiana, Michigan, Missouri, Nebraska, New Hampshire, New Mexico, Nevada, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Vermont, and Wyoming. *See id*. States such as Florida and New York also apply fiduciary obligations to brokers, but are not included in the study for reasons related to data availability. *See id*.

[23] The study has other important limitations. For example, as the authors candidly confess, they study the imposition of common-law fiduciary duties, and "State legislation or national rulemaking by [the SEC] may

induce a number of other effects." *Id.* at 4. Moreover, the authors lack data on state-level enforcement activity, and it is well-known that statewide variation in enforcement capabilities can have an *ex ante* impact on broker advice—and even the courts' decision to impose a fiduciary standard *ex post*. *See, e.g.*, Ben Charoenwong, Alan Kwan & Tarik Umar, *Does Regulatory Jurisdiction Affect the Quality of Investment-Adviser Regulation?* (working paper Jan. 31, 2019) (showing that, following Dodd-Frank's shift of regulatory jurisdiction over mid-sized investment advisers from the Commission to state securities regulators, evidence emerged of more fiduciary violation complaints with state-registered investment advisers where state regulators have fewer resources).

[24] Matt Levine, Bloomberg View: Money Stuff (May 24, 2019) ("Is it good for you if your investment adviser is a fiduciary? I mean yeah probably, seems reasonable. . . . [This paper provides] direct evidence that the [brokers acting as] fiduciaries are just *better*.").

[25] *See* Final Rule, *supra* note 6, at 641 & n.1349 (arguing that "the analysis may not fully capture certain aspects of the market for annuities, including whether financial professionals bound to the standard of conduct in one state can sell securities to customers in other states"). Although many methodological questions can and should be raised about this particular study, *see supra* note 23, the degree to which brokers can sell securities to customers in other states is not a valid one. The reason, of course, is that the law governing these questions is discoverable, *see, e.g.*, North American Securities Administrators Association, State Investment Adviser Registration Information (last accessed June 3, 2019), and we could and should have examined it rather than speculate about how it could confound evidence contrary to our policy priors.

[26] Similarly, with respect to Form CRS, I'm surprised by the release's claim that we chose not to conduct testing about whether ordinary investors understand our new disclosures because, in light of the flexibility we're giving firms to describe themselves as they see if, such testing would not be "practicabl[e]." As our former Chief Economists wrote to us, "a critical question remains unaddressed in the [economic analysis]: will the required new disclosures meaningfully inform customers?" Letter to Brent J. Fields, *supra* note 18. It is astonishing that, as we finalize these rules today, we still do not know the answer to our former colleagues' question.

[27] *New State Ice Co.* v. *Liebmann*, 285 U.S. 262 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country. . . . [Federal lawmakers have] the power to prevent an experiment. . . . But, in the exercise of this high power, we must be ever on our guard lest we erect our prejudices into legal principles.").

[28] The release is right, of course, to say that "the preemptive effect of Regulation Best Interest on any state law governing the relationship between regulated entities and their customers [will] be determined in future judicial proceedings." Final Rule, *supra* note 6, at 43; *Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137, 177 (1803) (Marshall, C.J.) ("It is emphatically the providence and duty of the Judicial Department to say what the law is."). I would have said no more. *Compare* Final Rule, *supra* note 6, at 43 ("Regulation Best Interest [and its companion releases] will serve as focal points for promoting clarity, establishing greater consistency in the level of retail customer protections provided, and easing compliance across the regulatory landscape.").

[29] *Compare* Letter to Vanessa Countryman, Acting Sec'y, Securities and Exchange Commission, from North American Securities Administrations Association, Inc. (April 25, 2019), at 2 n.5 ("[A] simple disclosure that the Commission is not intending to change existing law in this area is all that need be said") *with* Letter to Vanessa Countryman, Acting Sec'y, Securities and Exchange Commission, from the Securities Industry and Financial Markets Association (March 29, 2019), at 2 (arguing that a state-by-state approach "runs a significant risk of imposing regulations that are . . . costly[and] burdensome," and would impose "an uneven patchwork of laws").

[30] Winston Churchill, The Lord Mayor's Luncheon, Mansion House (November 10, 1942) ("Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.").

[31] *See, e.g.*, CFP Board, For CFP Professionals: Code of Ethics, Rules of Conduct, Practice Standards and Disciplinary Rules (2018).

Related Materials

- Data Appendix