

SEC – Don’t Throw Away Your Shot!
A Renewed Call for a Uniform Fiduciary Standard to Protect Individual Investors

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Thank you. I am very honored and humbled to join you today to deliver the seventeenth annual A.A. Sommer, Jr. Corporate, Securities and Financial Law Lecture. I’d like to thank both Morgan Lewis and Fordham Law for giving me the honor to address you this evening. And it is extra special to deliver this lecture in front of some of Al’s family members who I had the pleasure to meet a few moments ago.

Introduction

Al was a giant among corporate and securities lawyers. He was a forward thinker. In fact, the topic I have chosen to address this evening is both a tribute to the forward thinking of Al Sommer, and also an important story that remains very much in-progress. My address is entitled, *SEC – Don’t Throw Away Your Shot!* It is both a nod to the Broadway smash hit *Hamilton*,³ but more importantly, it is a renewed call for the SEC to create a uniform fiduciary standard to protect individual investors.

Al foretold the emergence and expansion of fiduciary duties in the securities industry – and that was nearly four decades ago – in 1978, when he penned a law review article entitled, *Fiduciary Duties – The Search for Content*.⁴ Al began that article with a celebrated quote from Justice Frankfurter that is as relevant today as it was back then, namely:

“To say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge those obligations? And what are the consequences of his deviation from the duty?”⁵

This quote touches on a key concept in today’s fiduciary debate. And that is – while there are some fundamental and uniform elements of a fiduciary duty – no matter the context – it

¹ Mr. Hammerman is Executive Vice President and General Counsel, SIFMA. He delivered this address at Fordham University School of Law on November 10, 2016 at the seventeenth annual A.A. Sommer, Jr. Corporate, Securities and Financial Law Lecture. Mr. Hammerman deeply appreciates the assistance of his longtime colleague, Kevin M. Carroll, in both the preparation of this article and his counsel on the long running fiduciary duty debate. This article has been submitted for publication in the Fordham Journal of Corporate and Financial Law.

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³ In the song *My Shot*, Hamilton forcefully states, “I am not throwing away my shot!” – meaning that he plans to actively apply his efforts and talents to the movement for U.S. independence from the British regime. LIN-MANUEL MIRANDA, *MY SHOT* (Hamilton) (2015).

⁴ A. A. Sommer Jr., *Foreword: Fiduciary Duties – The Search for Content*, 9 LOY. U. CHI. L.J. 525 (1977-1978).

⁵ *SEC v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943).

is equally true that the manner in which fiduciary duty is applied in any specific context has elements of uniqueness that justify separate consideration.

As the General Counsel of SIFMA, I am reminded of this duality every day. Our members include broker-dealers, banks, and investment advisers, which recognize that they must act in their clients' best interests every day – or risk losing those very clients. There is, however, no one-size-fits-all “best interests” – or fiduciary – standard that now applies – or that ever could apply – to the diverse group of business models and functions that our members follow and perform.⁶ And yet, for many years now, SIFMA has been on record calling for the SEC to create a uniform fiduciary standard.

How can that be? How did that come to pass? Or, as Lin-Manuel Miranda's Hamilton⁷ might have phrased it: How does an intensely regulated broker-dealer firm operate so smart, yet get caught-up in a raging debate over whether he has the clients' best interests at heart?

Our story may not be quite as dramatic as *Hamilton*, but let me provide a roadmap of the three key points that I'd like you to take-away from tonight's lecture:

- First, let's understand the problem. *What is a uniform fiduciary standard intended to solve for? When did the problem originate, and where do things stand today?*
- Second, let's present a solution to the problem. *What is the optimal path forward?*
- Third and finally, let's remove impediments to the solution. Here, I'll touch on why SIFMA is suing the DOL – and why I think we will win.

I. HISTORY OF THE FIDUCIARY DUTY DEBATE

Let's start with the functions that investment advisers and brokers perform. The core function of investment advisers is to provide continuous investment advice to their clients.⁸ Some also provide financial planning services and reports on securities.⁹ Brokers, on the other hand, operate across a far broader spectrum.¹⁰ While many brokers provide investment advice,

⁶ See, e.g., Jennifer L. Klass and Eric L. Perelman, *The Evolution of Advice: Digital Investment Advisers as Fiduciaries* (October 2016) available at <https://www.morganlewis.com/pubs/the-evolution-of-advice-digital-investment-advisers-as-fiduciaries> (concluding that fiduciary standards under the securities laws are flexible standards that can that can accommodate evolving business models, innovation in products and services, and even technological changes – including the advent of the “robo advisor” (which is automated, algorithm-based investment advice)).

⁷ Lin-Manuel Miranda is the sole creator and star of *Hamilton*.

⁸ See Comment Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Sec. & Exch. Comm'n at 11 (July 5, 2013) available at <http://www.sifma.org/issues/item.aspx?id=8589944317>.

⁹ *Id.*

¹⁰ See Michael Koffler, *Six Degrees of Separation: Principles to Guide the Regulation of Broker-Dealers and Investment Advisers* 41 SRLR 766, 3 (2009) available at

many others do not. Instead, they focus their business activities on clearing and settling trades, underwriting securities, or serving as market makers, for example.¹¹

Why is this important? Because the fiduciary debate focuses on the narrow overlap in services provided by brokers and investment advisers – that is – when they provide personalized investment advice to their retail clients. Yet, even when brokers and advisers engage in the same service, there are important differences between the investment advice they provide.

Investment advisers, on the one hand, provide continuous and regular investment advice to their clients, which entails an ongoing duty to supervise the account, regardless of whether any trading occurs.¹² The compensation structure of investment advisers reflects this business model. Over 95% of investment advisers registered with the SEC charge their clients fees based on the percentage of assets under management.¹³ In contrast, brokers typically provide episodic investment advice incidental to a specific transaction, and are compensated through commissions or similar transaction-based arrangements.¹⁴ Most retail investors, including retirement savers, choose brokerage accounts because they are “buy and hold” investors and brokerage accounts are a more cost-effective choice.

Another key difference is that investment advisers generally exercise investment discretion over their client accounts, meaning that the adviser has the power – granted by the client – to trade on the client’s behalf without even speaking with the client.¹⁵ Brokers, on the other hand, provide non-discretionary advice.¹⁶ A broker generally cannot trade on his or her client’s behalf; instead, the broker makes an investment recommendation, and the client is free to take it or leave it.

Of course, the biggest difference between brokers and advisers is the way they are regulated – under a structure that traces its roots back to the 1930’s and 1940’s with the passage of the federal statutes that govern brokers and advisers. As this group well knows, investment

<http://www.sutherland.com/portalresource/lookup/poid/Z1tOI9NPluKPtDNIqLMRV56Pab6TfzCRXncKbDtRr9tObDdEv0JDuo0!/fileUpload.name=/PDFArtic42709.pdf>.

¹¹ See *id.*

¹² See Hammerman *supra* note 8, at 11; see also, Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisors*, 55 VILL. L. REV. 701, 727 (2010) (“Most advisers...agree to provided portfolio management services. The phrase “management services” connotes an ongoing relationship which extends beyond the time a particular trade is made. Moreover, the scope of activity for federally registered advisers is usually to provide ongoing, continuous services, even for a non-discretionary account”).

¹³ SEC. & EXCH. COMM’N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 7 (2011) available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

¹⁴ See Hammerman *supra* note 8, at 11.

¹⁵ See *Investment Advisor*, INVESTOPEDIA.COM, <http://www.investopedia.com/terms/i/investmentadvisor.asp> (last visited Sept. 16, 2016) (“Often, investment advisers have a level of discretionary authority, allowing them to act of the behalf of their clients without having to obtain formal permission prior to executing an action. However, discretionary authority must be formally provided by the client, and it is generally arranged as part of the client on-boarding process”).

¹⁶ See Hammerman *supra* note 8, at 12.

advisers are governed by the Investment Advisers Act of 1940 (the “Advisers Act”).¹⁷ The Advisers Act does not expressly mandate a fiduciary duty for advisers, but one was read into the Act by the famous 1963 Supreme Court decision in *Capital Gains*.¹⁸ In that case, the Court held that Section 206 of the Advisers Act imposes fiduciary duties on investment advisers by operation of law.¹⁹

Brokers, on the other hand, are governed by the Securities and Exchange Act of 1934 (the “Exchange Act”).²⁰ Under the Exchange Act, a broker that provides personalized investment advice and recommendations to retail clients is generally not a fiduciary, but owes a duty of fair dealing to clients.²¹ Under the so-called “shingle” theory, in hanging out his or her shingle, a broker is making an implied representation that the public will receive fair and professional advice.²²

Why then, you may ask – when brokers engage in the same conduct as advisers (i.e., providing investment advice) – don’t they need to comply with the presumably higher fiduciary standard under the Advisers Act?

The answer lies in the broker-dealer exclusion. In passing the Advisers Act, Congress saw fit to provide an exclusion for the episodic, non-discretionary, investment advice that brokers typically provide to their clients. Thus, under the Advisers Act, brokers are excluded from the definition of “investment adviser” where the investment advice they provide is “solely incidental” to their brokerage business and when they receive “no special compensation” for the advice (the “broker-dealer exclusion”).²³

“No special compensation” generally means that brokers can charge only commissions, and not asset-based fees like investment advisers. “Solely incidental” advice, however, encompasses virtually all investment advice provided by brokers to their retail clients. Indeed, the SEC has long-recognized that the advice provided by broker-dealers “is substantial in amount, variety, and importance to their customers.”²⁴ Thus, under the broker-dealer exclusion,

¹⁷ Investment Advisers Act of 1940, §§ 201-224, 15 U.S.C. §§ 80b-1-21 (2012).

¹⁸ *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 84 S. Ct. 275 (1963).

¹⁹ 375 U.S. at 191.

²⁰ Securities Exchange Act of 1934, 15 U.S.C. § 78a (2012).

²¹ See SEC. & EXCH. COMM’N, *supra* note 13, at iv (“Under the antifraud provisions of the federal securities laws and SRO rules... broker-dealers are required to deal fairly with their customers. 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”).

²² See FINRA Regulation of Broker-Dealer Due Diligence in Regulation D Offerings, Practical Law Practice Note 4-507-0665 (last visited Sept. 9, 2016) *citing* *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969).

²³ Advisers Act § 202(a)(11)(C).

²⁴ See SEC Release No. 34-50980 (Jan. 6, 2005), available at www.sec.gov/rules/proposed/34-50980.htm. Brokers “commonly give a certain amount of advice to their customers in the course of their regular business and ... it would be inappropriate to bring them within the scope of the [Advisers Act] merely because of this aspect of their business.” Opinion of the General Counsel Relating to Section 202(a)(11)(C) of the Advisers Act, Advisers Act Release No. 2 (Oct. 28, 1940), 11 Fed. Reg. 10996 (Sept. 27, 1946).

the line between broker and investment adviser activity primarily focuses on the form of compensation rather than the substance of a broker's activity. The broker-dealer exclusion reflects Congress's clear understanding that there is a natural interrelationship between brokerage services and providing investment advice, and that brokers are already comprehensively regulated under the Exchange Act.²⁵

Indeed, over the intervening eight-plus decades, the SEC, FINRA and state securities regulators who oversee brokers have developed a fulsome regulatory regime based on brokers' duty of fair dealing²⁶ – including the obligation to make suitable recommendations, ensure best execution, and observe high standards of commercial honor and just and equitable principles of trade – a concept which itself embodies fiduciary principles.²⁷ Brokers are also subject to routine and regular exams from the SEC and FINRA – approximately once every other year – as opposed to the once every 10 – 13 years visits that investment advisers receive from the SEC.²⁸ Thus, today both brokers and advisers currently operate under high – albeit somewhat different – standards of conduct that have developed under separate statutory and regulatory schemes over many decades.

So far, so good. *So, what happened – what changed?*

The short answer is that brokers changed. In the late 1980s and early 1990s, brokerage firms first started to introduce new types of full service accounts – known as fee-based brokerage accounts – that emphasized the importance of the investment advice they provided, and that changed their compensation structure to a fee-based model, just like investment advisers.²⁹

A few years later, in May 1994, then SEC Chairman Arthur Levitt³⁰ formed a broad-based committee led by Dan Tully, then Chairman and CEO of Merrill Lynch, to recommend best practices for managing conflicts of interest in the brokerage industry. The following year, in April 1995, the committee issued its final report – the Tully Report, which identified as a best

²⁵ See Speech by SEC Commissioner Elisse B. Walter, *Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization?* (Mutual Fund Directors Forum, May 5, 2009) available at <https://www.sec.gov/news/speech/2009/spch050509ebw.htm>.

²⁶ MORGAN, LEWIS & BOCKIUS LLP, DEPARTMENT OF LABOR RETIREMENT INITIATIVE FAILS TO CONSIDER CURRENT REGULATORY REGIME, WHICH COMPREHENSIVELY PROTECTS INVESTORS INCLUDING IRA INVESTORS, AND PRESERVES INVESTOR CHOICE (2015) (explaining how the current framework governing financial professionals protects investors as broker dealers and their registered representatives are subject to extensive regulatory oversight in addition to investors' private rights of action).

²⁷ See *In re E.F. Hutton & Co. Inc.*, Release No. 25887, 41 S.E.C. Docket 413, 418 (July 6, 1988) (“The concept of just and equitable principles of trade embodies basic fiduciary responsibilities....”).

²⁸ *Investment Adviser Oversight Act of 2012: Hearing on H.R. 4624 Before the H. Comm. on Fin. Servs.*, 112th Cong. (2012) (statement of Richard G. Ketchum, Chairman and CEO of FINRA) available at <http://financialservices.house.gov/uploadedfiles/hhrg-112-ba-wstate-rketchum-20120606.pdf>.

²⁹ See Koffler *supra* note 10, at 2-3.

³⁰ Incidentally, Mr. Levitt delivered the inaugural A.A. Sommer, Jr. lecture seventeen years ago and perhaps not coincidentally, he mentioned the importance of a fiduciary standard for those “charged with the care of other people's money.” Arthur Levitt, Jr., *Costs Paid with Other People's Money*, Inaugural Address, A.A. Sommer, Jr. Annual Lecture in Corporate, Securities & Financial Law (Nov. 3, 2000).

practice that brokers should be compensated using asset-based fees (just like investment advisers), instead of commissions.³¹ The thinking was that commissions created an incentive for brokers to trade too frequently to generate income (also known as “churning”), and that often the best advice a broker can give a client is to do nothing. The Tully Report viewed fee-based brokerage as a means to better align the interests of brokers and their clients.³²

The Tully Report and Chairman Levitt himself encouraged fee-based brokerage accounts to proliferate. As they did, concerns arose among brokers and regulators that this form of compensation could be viewed as “special compensation,” thereby invoking the Advisers Act. So, in 1999, the SEC stepped-in and proposed Rule 202(a)(11)-1 which would exempt brokers offering fee-based accounts from being deemed investment advisers if they satisfied certain conditions.³³

The proposed rule was very controversial. Independent investment advisers, represented by the Financial Planning Association (“FPA”), didn’t like the heightened and more direct competition from brokers that the proposed rule would allow. Regardless, the SEC adopted the rule in April 2005.³⁴ But shortly thereafter, the FPA sued the SEC to invalidate the rule. And, in 2007, the D.C. Circuit court did just that, ruling that the SEC had exceeded its authority when it adopted the rule.³⁵

The D.C. Circuit decision caused the SEC to reconsider the distinction between brokers and advisers and so, in 2008, it commissioned a study from the RAND Corporation, which found that while investors were generally happy with the service provided by their broker or adviser, these investors generally did not understand, or were confused by, the differences between the duties owed by brokers and advisers under the securities laws.³⁶

II. SIFMA’S FIDUCIARY POSITION AND THE PATH FORWARD

³¹ ¶ 85,614 Report of the Committee on Compensation Practices, Fed. Sec. L. Rep. P 85614 (C.C.H.) (1995).

³² Notably, while an asset-based fee may reduce the likelihood of churning, it also increases the chance that a broker will ignore a customer’s account – aptly called “reverse churning” – because the broker will get paid regardless of whether a transaction occurs. See Thomas P. Lemke & Gerald T. Lins, *Regulation of Investment Advisers* §2:116 (2010) (“wrap fees may give rise to ‘reverse churning’ (i.e., a lack of trades in an account that otherwise would have been made had the client been paying separate commissions for them).”).

³³ SEC Certain Broker-Dealers Deemed Not to be Investment Advisers, 17 C.F.R. §§ 275, 279 (1999) available at <https://www.sec.gov/rules/proposed/34-42099.htm>.

³⁴ Inv. Adv. Release No. 2376 (April 12, 2005).

³⁵ *Financial Planning Assn v. SEC*, 482 F.3d 481 (D.C. Cir., Mar. 30, 2007).

³⁶ The 2008 RAND study focused on retail investors’ understanding of the differences in duties owed to clients by brokers and advisers. The study made clear that the convergence – over the past two plus decades – of broker and investment adviser activity in the investment advice space was generating confusion among investors. At the same time, it presented an opportunity to eliminate, or render irrelevant, such confusion by establishing a uniform standard. See ANGELA A. HUNG ET AL., SEC. & EXCH. COMM’N, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS (2008) available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

Throughout the following year – 2009, numerous members of Congress and their staff, and senior officials at the SEC and FINRA and their staff, expressed their desire and intent to harmonize the regulatory regime for brokers and investment advisers.³⁷ At the time, there was widespread acceptance that the harmonized standard should be a fiduciary one, under the belief that it represents the highest standard and investors deserve no less.

SIFMA and its members were keenly aware that change was in the air. Against this backdrop, we shared an expectation that some form of harmonized legislation and/or regulation would ultimately emerge from all the chatter. We wanted to be part of the conversation and more importantly, part of a positive and constructive solution. Particularly in the wake of the 2008 financial crisis, we wanted to make very clear and public that our industry firmly supports consistent and high standards for interacting with individual clients, including putting the client's interest first.

Thus, in July 2009, SIFMA's Private Client Group convened, and in an act of leadership passed a one-page resolution declaring SIFMA's support for a fiduciary standard. A few days later, on July 17, 2009, SIFMA issued a press release announcing our support for a new federal fiduciary standard for brokers and investment advisers when providing personalized investment advice to retail clients.³⁸ Under this new standard, we explained, "it won't matter who is giving the advice – broker or adviser – investors will be protected by the exact same federal fiduciary standard when receiving the same services."³⁹

One year later, on July 15, 2010, Congress passed the Dodd-Frank Act.⁴⁰ With respect to the fiduciary issue, § 913 of the Act authorizes the SEC to write rules to implement a new, uniform fiduciary standard of conduct applicable to both broker-dealers and investment advisers, when they provide "personalized investment advice about securities to retail customers."⁴¹ § 913 requires that the uniform fiduciary standard be "no less stringent than" the general fiduciary duty implied under Section 206 of the Advisers Act.

³⁷ See e.g., Walter, *supra* note 25.

³⁸ Press Release, SIFMA, SIFMA Unveils New Pro-Consumer Reforms (July 17, 2009) available at <http://www.sifma.org/news/news.aspx?id=12442>.

³⁹ That same day, SIFMA testified before Congress in a hearing entitled "*Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals*." See SIFMA testimony before the H. Fin. Servs. Comm., 111th Cong. (July 17, 2009), <http://www.sifma.org/issues/item.aspx?id=1515>. In that testimony, SIFMA further developed its position by suggesting that the new standard of conduct should: (i) be promulgated by the SEC, (ii) not subject financial professionals to obligations under other potentially burdensome or conflicting fiduciary regimes (such as ERISA or state common law), (iii) provide for management – and not elimination – of conflicts of interest, and (iv) apply only to, and be tailored for, those services and activities involving personalized investment advice to retail clients. A few months later, SIFMA provided further testimony to House Financial Services in support of a uniform fiduciary standard – this time in response to a discussion draft of what would ultimately become the Dodd-Frank Act. SIFMA testimony before the House Financial Services Committee (October 6, 2009), <http://www.sifma.org/issues/item.aspx?id=1519>.

⁴⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

⁴¹ *Id.*

The SEC has no deadline to act, and – as we are all painfully aware more than six years later – is not required to take any action at all.

So, what is SIFMA asking the SEC to do with its Dodd-Frank § 913 authority?

We are asking the SEC to do precisely what Congress intended and what § 913 requires, namely, to articulate the fiduciary duty implied under Section 206 of the Advisers Act through new rulemaking for broker-dealers under the Exchange Act. The SEC should issue the necessary rules and guidance to enable broker-dealers to apply the standard to their distinct operational model.⁴²

Importantly, upon establishing the new, rule-based standard contemplated by Section 913, brokers should not be subject to existing rules, guidance and legal precedent under Section 206 of the Advisers Act. Such rules, guidance and legal precedent would continue to apply to investment advisers – as they were initially designed and intended – but would not apply to brokers whose business models differ from investment advisers.

The plain language of § 913, together with the legislative history of Dodd-Frank, make clear that the requirement that the uniform fiduciary standard be “no less stringent than” the general fiduciary duty implied under Section 206 of the Advisers Act does not require the SEC to impose Advisers Act rules, guidance and legal precedents on broker-dealers. Don’t take our word for it: Congressman Barney Frank – a primary author of Dodd-Frank – said so explicitly in a letter to the SEC Chair in 2011.⁴³

So, what’s the problem with extending Advisers Act guidance and precedent to brokers?

The problem is that such guidance and precedent is based upon the specific types of services provided and disclosures made by investment advisers and thus, it is inherently not directly applicable to broker-dealers. This is a critically important point. And – it is the same point that Al Sommer wrote about four decades ago – namely, that establishing that an intermediary is a fiduciary who is required to act in the best interests of investors is only the beginning of the analysis, not the end.⁴⁴

⁴² New Exchange Act rules, for example, should be crafted to expressly preserve brokers’ ability to engage in principal transactions under the new standard without the need to obtain specific trade-by-trade prior written consent as is currently required under the Advisers Act.

⁴³ Letter from Congressman Barney Frank to Mary Schapiro, Chairman, Sec. & Exch. Comm’n 1 (May 31, 2011) (“‘no less stringent’ ... was not intended to encourage the SEC to impose the ... Advisers Act... standard on broker-dealers....”).

⁴⁴ The contours of one’s fiduciary obligation are highly contextual and depend on the scope of one’s responsibilities as defined by agreement and the factual circumstances of the relationship. The trustee of a family trust, for example, is held to a fiduciary standard but how that standard is applied will differ from how it is applied to a corporate fiduciary. See RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. e (2006) (“Any agent has power over the principal’s interests to a greater or lesser degree. This determines the scope in which fiduciary duty operates.”). In the context of brokers and investment advisers, the specific rules and guidance that should apply to brokers when providing episodic, non-discretionary, advice solely incidental to securities transactions will need to be different from that currently applicable to investment advisers under the Advisers Act, who generally provide continuous, discretionary advice subject to ongoing supervision and monitoring – even if both are derived from a uniform fiduciary standard.

Because of fundamental differences between brokers and investment adviser roles and business models, attempting to apply Advisers Act guidance and precedent to brokers without further clarification by the SEC would create a high risk of confusion and misapplication, resulting in unnecessary legal and compliance costs under the new standard. At a minimum, SEC rules and guidance should adequately address the full range of common scenarios that brokers face in their daily dealings with clients.

As we have limited time this evening, allow me to articulate one scenario that is very common today that the SEC would need to address through clear guidance at the time a uniform fiduciary standard of conduct is formally adopted. Let's call this scenario "The Holistic Review of the Client Relationship."⁴⁵ Following is an example of how this scenario might play out:

- Transaction: As a result of several months of market volatility, Lucy and Jon Smith ask their broker to meet with them to provide a review of the overall performance of all of the family's accounts held at the firm. The broker responds and provides the Smiths with a review of the fee-based as well as other accounts which include transactional brokerage, self-directed accounts, IRAs, and the kids' 529 college plan accounts.
- Required SEC Guidance: If the broker chooses to provide the Smiths with a holistic review of all of their accounts – including "no advice" brokerage and self-directed accounts (which are not subject to a fiduciary duty), then SEC regulatory guidance should address whether or not the broker may create new fiduciary obligations for the "no advice" accounts by "doing the right thing" for the client.

Even though there are many unanswered questions, SIFMA has laid the foundation, provided the data, and presented a compelling case for the SEC to exercise its § 913 authority over these past seven years.

Since 2009, SIFMA's advocacy on the fiduciary issue has included:

- Congressional testimony on 5 separate occasions,⁴⁶

⁴⁵ SIFMA has identified and presented additional scenarios to the SEC, including for example: (i) unsolicited transactions – brokerage account, (ii) solicited transactions – brokerage account, (iii) principal transactions, (iv) initial public offering (IPO), (v) sale of proprietary products, and (vi) allocation of investment opportunities. For examples of these scenarios, and the regulatory questions raised by them, see SIFMA comment to SEC (May 4, 2012), <https://www.sifma.org/issues/item.aspx?id=8589938634>.

⁴⁶ (i) SIFMA testimony before the Senate Banking Committee (March 10, 2009), <http://www.sifma.org/issues/item.aspx?id=1510>. (ii) SIFMA testimony before the House Financial Services Committee (July 17, 2009), <http://www.sifma.org/issues/item.aspx?id=1515>. (iii) SIFMA testimony before the House Financial Services Committee (October 6, 2009), <http://www.sifma.org/issues/item.aspx?id=1519>. (iv) SIFMA testimony before House Financial Services Committee (Sep. 13, 2011), <http://www.sifma.org/issues/item.aspx?id=8589935390>. (v) SIFMA testimony before House Financial Services Committee (June 6, 2012), <http://www.sifma.org/issues/item.aspx?id=8589938957>.

- 6 separate comment letters to the SEC,⁴⁷
- 1 comment letter to FINRA,⁴⁸ and
- countless media interviews, op-eds, and public speaking engagements on the topic.

SIFMA's work product includes:

- two economic study reports, quantifying the costs and expenses under various approaches to harmonization,
- two reports providing a detailed roadmap for SEC rulemaking under Dodd-Frank § 913, and
- a robust cost-benefit analysis, ultimately concluding that the benefits of a uniform fiduciary standard far outweigh the costs.

We have a statute that authorizes it, an industry that wants it, and two consecutive SEC Chairs that say it's a top priority. *So why don't we have a uniform fiduciary standard today?*

At this moment, I hope we achieve a moment of clarity, leadership and forward-thinking. My hope is that the SEC and its Chair take a cue from the *Hamilton* cast – performing eight shows a week just a few blocks from here – and “Don't throw away your shot!” At the risk of continuing my homage to *Hamilton*, I'm reminded of the famous line that Hamilton raps when speaking of Aaron Burr, his friend, rival, nemesis and his ultimate killer in their famous duel. “If you stand for nothing, Burr, what'll you fall for?”⁴⁹ So, to our colleagues at the Commission, I sincerely hope they can take a stand and produce some tangible action on this important investor protection issue covered by Dodd-Frank § 913.

III. SIFMA'S DOL LITIGATION

In the meantime, what else can SIFMA do to further pave the way for an eventual uniform fiduciary standard?

I'm glad you asked. That is what our legal challenge to the Department of Labor (“DOL”) fiduciary rule is intended to do. As now should be crystal clear, our pending lawsuit with the DOL is not a fight against a fiduciary standard. As I've said, SIFMA is firmly pro-fiduciary. Rather, our lawsuit is necessary because of the botched manner in which the DOL is attempting to achieve its goal.

⁴⁷ (i) SIFMA comment to SEC (Aug. 30, 2010), <https://www.sifma.org/issues/item.aspx?id=22263>. (ii) SIFMA & Oliver Wyman comment to SEC (Nov. 1, 2010), <http://www.sifma.org/issues/item.aspx?id=21999>. (iii) SIFMA & Oliver Wyman comment to SEC (Nov. 17, 2010), <http://www.sifma.org/issues/item.aspx?id=22336>. (iv) SIFMA comment to SEC (July 14, 2011), <http://www.sifma.org/issues/item.aspx?id=8589934675>. (v) SIFMA comment to SEC (May 4, 2012), <https://www.sifma.org/issues/item.aspx?id=8589938634>. (vi) SIFMA comment to SEC (July 5, 2013), <https://www.sifma.org/issues/item.aspx?id=8589944317>.

⁴⁸ SIFMA comment to FINRA (Dec. 3, 2010), available at: <http://www.sifma.org/issues/item.aspx?id=22482>).

⁴⁹ LIN-MANUEL MIRANDA, AARON BURR, SIR (Hamilton) (2015).

The DOL has, unfortunately, injected itself into the fiduciary debate covered by Dodd-Frank and created a rule that applies to one sliver of investment advice in the only space it has jurisdiction – that is, Individual Retirement Accounts (“IRAs”) and 401(k)s. The DOL rule creates a confusing, bifurcated system for both financial advisors and their clients – and it stands in direct conflict with the uniform fiduciary standard contemplated under Dodd-Frank. Moreover, the DOL rule will be extremely costly and will limit Americans’ access to retirement planning advice. Some clients – particularly small accounts – may become too expensive to service and will get dropped. Others will be forced into asset-based accounts where they will pay more for their advice.

OK, so DOL got it wrong. But does that mean they violated the law?

In this case, yes. Our lawsuit details three major violations:

First, the DOL rule is not informed by, or the product of, an adequate cost-benefit analysis, as it is required to be. In fact, the independent investment research firm Morningstar calculated that the rule could cost investors \$13 billion in additional fees.⁵⁰

Second, the DOL exceeded its statutory authority in promulgating this rule. The rule over-broadly redefines who is a fiduciary and in doing so, it sweeps in every person who sells a retirement-related product, and then prohibits them from receiving forms of compensation (such as sales commissions) that have been a mainstay of their business models for decades.

The DOL rule improperly intrudes upon the jurisdiction of the SEC, which was directed by Congress to create a uniform fiduciary standard. The SEC’s jurisdiction applies to all investment advice, whereas DOL’s is limited only to retirement accounts. The SEC has extensive enforcement and examination authority. The DOL, however, has no enforcement or examination authority over IRAs. The DOL rule is like the tail wagging the dog. The DOL must yield to the SEC in this already-claimed space.

Third, finally, and perhaps most importantly, our lawsuit takes issues with the rule’s “Best Interest Contract” (or “BIC”) Exemption, which essentially forces firms to enter into legally binding contracts with clients in order to continue doing business on the same terms, and to subject themselves to class action lawsuits from the plaintiffs’ bar that the DOL has no authority to impose. The DOL thus abused its exemptive authority by forcing financial professionals to rely on the BIC exemption, and then conditioned that exemption on their “agreement” to requirements and liabilities that DOL has no power to impose or enforce. And, precisely because the DOL has no enforcement authority in this area, it has delegated enforcement to private and class action litigation.

⁵⁰ The DOL is thus grossly discounting – or ignoring – the costs and burdens of its rule. SIFMA’s lawsuit is intended to protect investors from a rule that will make giving and receiving advice significantly more expensive for hardworking Americans saving for retirement. See Michael M. Wong et al., *The U.S. Department of Labor’s Fiduciary Rule for Advisors Could Reshape the Financial Sector*, MORNINGSTAR: FIN. SERVS. OBSERVER, Oct. 2015, at 2 available at http://www.advisor.ca/wp-content/uploads/2015/11/FinancialServicesObserver_DOL-Oct2015.pdf.

The inclusion of a “private right of action” mechanism creates unlimited risk for firms, who will always face the threat of individual claims or class action litigation and consequently will be forced to alter their advisory practices to offer fewer investment options and services. It is truly unprecedented, exploitative and improper action by a federal agency.⁵¹ That is why we have taken legal action to stop this rule.

We are confident that the courts will see how the DOL exceeded its authority and created a rule so complex and costly that it will make receiving and giving financial advice more expensive for hardworking Americans saving for retirement.

Conclusion

That brings me to my conclusion. I hope each of you will take-away a better understanding of the origins of the call for a uniform best interest standard, SIFMA’s views on how to implement it – and the urgency of our call to do so now and finally, why we were compelled to litigate with DOL to maintain the promise of a uniform fiduciary standard.

The future remains uncertain. Our DOL case goes to hearing next week, and the SEC’s direction under its Dodd-Frank authority remains murky. Who knows, maybe seventeen years from now, at the 34th annual A.A. Sommer lecture in 2033, when we’ve all converted to the fee-based advisory model, that year’s lecture will lament the death of – and call for the return of – the commission-based brokerage account, while we all scratch our heads wondering: *How did we get to this point?*

Stranger things could happen. Stay tuned. This saga has many chapters still to go. And, for my final *Hamilton* reference, whenever the fiduciary debate ultimately gets sorted out, all I know is, “I wanna be in the room where it happens.”⁵²

Thanks for listening. And again, thank you for the honor of addressing you this evening.

⁵¹ Indeed, one of the rule’s key architects, DOL Assistant Secretary Phyllis Borzi, explained in a *Think Advisor* article from May 25, 2016 that the DOL intends to subcontract to plaintiffs’ lawyers and the class action bar enforcement of the new regulatory scheme that it lacks powers to enforce itself. In the words of Ms. Borzi: “Back in the day, when people wanted to make changes, they passed legislation,” but “what we’ve done” with the new Rule “is we’ve shifted from the way that social change and legal change and financial change is accomplished through congressional action to two different avenues for making changes: The main one being regulation and the second one being litigation.” The DOL lacked direct statutory authority over IRAs, she explained, and therefore “we had to be creative to try to find a way to” create enforceable rights; “that’s how we came up with the best interest contract exemption,” which “deputiz[es]” consumers to bring “state contract actions.” See *Borzi Highlights Changes to ERISA as She, Other Speakers Look Back at Law’s 40 Years*, Bloomberg BNA, 41 BPR 1929 (Sept. 9, 2014).

⁵² LIN-MANUEL MIRANDA, *THE ROOM WHERE IT HAPPENS* (Hamilton) (2015).