

# Fiduciary Reference

Analysis of Investment Fiduciary Issues

September 8, 2015

## SEC Commissioners Luis A. Aguilar's and Daniel M. Gallagher on Fiduciary Duty

*A review of the Commissioners' statements reveals sharply distinct visions of advice, the marketplace, the role of the SEC and the needs of individual investors*

Knut A. Rostad and Darren M. Fogarty \*

### Executive Summary

SEC Commissioners Luis Aguilar and Daniel Gallagher have announced they will leave the SEC when their replacements are selected.<sup>1</sup> Commissioner Aguilar has served seven years and Commissioner Gallagher almost four. The Commissioners depart at a time – in the midst of recent statements of SEC Chair White on the status of rulemaking at the SEC and the DOL proceeding with the Conflict of Interest Rule -- of unprecedented focus on fiduciary duties. This focus reveals sharply different visions. The commissioners' departure is an appropriate time to assess their views.<sup>2</sup>

- The Commissioners' statements on fiduciary duty reflect fundamentally different views of the very meaning of advice, the responsibilities of advisers or brokers rendering advice, the nature of a fiduciary / client relationship, and the appropriate role of the Securities & Exchange Commission.
- Commissioner Aguilar has spoken extensively on fiduciary duty's importance to investors and the capital markets. Particularly in 2009 and 2010, when the Obama administration first introduced the proposal for applying fiduciary duties to broker – dealers and Dodd Frank was enacted, Commissioner Aguilar spoke often and at greater length than did other commissioners or the SEC Chair.<sup>3</sup>
- Commissioner Aguilar repeatedly sounds themes of how the fiduciary standard protects investors and why this matters. Commissioner Aguilar is well aware of general investors' inexperience in investing, especially senior Americans. Noting that investors' do not have access to perfect information, – in fact, far from it due to the opaqueness of the industry – Commissioner Aguilar strongly supports Congress mandating that all providers of investment advice be fiduciaries as a means of protecting investors and restoring confidence in our financial system.

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<sup>1</sup> Visit <http://www.thinkadvisor.com/2015/05/18/secs-gallagher-aguilar-to-depart-as-agency-crafts> for more detailed information on both Commissioners' departures.

<sup>2</sup> Each Commissioners' public statements were collected from archives found on the SEC's website: <http://www.sec.gov/news/statements>. Correspondence with the commissioners' offices were sought to ensure no mentions references to fiduciary duty were missed.

<sup>3</sup> Out of 92 speeches and statements by Chairman Schapiro over the 2009-10 there were five mentions of fiduciary duty in 2009 and seven in 2010. Links to these speeches are provided in the Appendix. These 12 mentions over two years are fewer in number and less detailed than are Aguilar's discussions during the same period of time.

- Commissioner Gallagher joined the Commission in November 2011, and has been outspoken on fiduciary duty. The Commissioner provided a particularly detailed analysis of the origins of the Advisers Act of 1940 in an October 2012 speech, which underscores his rationale for opposing the Commission proceeding with a uniform standard. More recently, the Commissioner has spoken out strongly against the DOL’s proposed conflicts of interest rule.
- Commissioner Gallagher has a narrower view of fiduciary duty. The Commissioner questions the wisdom of a uniform fiduciary standard and he criticizes the DOL proposed Conflict of Interest Rule. The Commissioner’s views reflect a conviction that the present regulatory scheme and enforcement mechanisms generally work well for investors, industry participants and the capital markets.
- Aguilar and Gallagher: Opposing Visions. The commissioners do not just express different positions. They embody disparate visions. While Commissioner Aguilar “unequivocally supports” fiduciary duty (May 11<sup>th</sup>, 2010 Statement), Commissioner Gallagher believes a fiduciary requirement would “actually harm retail investors” (February 20<sup>th</sup>, 2015 statement). While Commissioner Aguilar notes how most investors are unaware their broker-dealers may not be a fiduciary, Commissioner Gallagher stresses how “investors benefit from choice: choice of products, choice in advice providers.”

## Conclusion

- “So divided philosophically..” The commissioners’ disparate visions of advice regulation reflect far more than the normal differences of competing positions. They reflect a core division noted by former SEC Chairman Arthur Levitt, in an Investment Adviser Association video, “The commissioners at the SEC are so divided philosophically, on this (fiduciary duty) ...that I believe they will be locked in conflict on this issue for a long, long time.”
- Chairman Levitt hits a point that is often overlooked. The philosophical divide *is* wide, so wide that credible research is often treated more like a political attack than research. Much government and academic research persuasively suggest that investor short-comings and brokerage conflicts harm investors and can be mitigated by fiduciary duties. This research is widely accepted – but not by fiduciary opponents who often ignore the research or just dismiss it out of hand.
- Commissioner Gallagher frequently suggests fiduciary advocates offer no justification for applying the fiduciary standard to brokers. Yet, when speaking of the White House memo justifying the DOL rule (see February 15 statement below), the Commissioner refuses to comment, saying “I am not going to be drawn into a debate about the studies the memo selectively cites.”
- Commissioners Aguilar and Gallagher embody disparate visions within the SEC and the body politic. Their statements deserve careful attention. While fiduciary advocates’ proposals are neither perfect nor without potential costs, they reflect fiduciary conduct. They reflect the meaning of relationships of trust and confidence. They are tethered by history and law and reason and common sense. Unlike product sales – whether in funds or cars or home appliances – they presume, as in law and medicine, financial advice deserves fiduciary status, that fiduciary advice is good for investors and conflicted advice is not.

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Yet, in contrast, fiduciary opponents who advocate for the ‘caveat emptor’ principles implicit in their views labeled “choice”, cannot, in simple good faith, make these statements. None of them. This is the crux of the importance of the “philosophical divide” noted by Chairman Levitt; the crux of the disparate visions the commissioners’ statements represent.

## SEC Commissioner Luis A. Aguilar’s Commentary on Fiduciary Duty and Investor Protection

### Introduction

Commissioner Aguilar has served at the SEC since he was sworn in on July 31<sup>st</sup>, 2008 and has been a longtime proponent of fiduciary principles and the establishing of a rigorous, uniform fiduciary standard for broker-dealers and investment advisors alike. Found below are highlights of his work from his speeches.

### Speeches in Chronological Order (2009-2015)

**Forward note:** There are many in-text citations which appear in Commissioner Aguilar’s original public statements, but are not included in the quotes below for clarity purposes.

#### SEC's Oversight of Adviser Industry Bolsters Investor Protection – May 7, 2009

Link: <http://www.sec.gov/news/speech/2009/spch050709laa.htm>

Quote not provided as entire speech is about Fiduciary Duty and the Fiduciary Standard.

#### Creating Reform That Is Sustainable for Investors – October 9<sup>th</sup>, 2009

Link: <http://www.sec.gov/news/speech/2009/spch100909laa.htm>

Quote clarifying that broker-dealers are, indeed, fiduciaries:

*Much has been written and spoken, including by me, about the discussions under way about broker-dealers who provide investment advice. Investment advisers have long been recognized to be fiduciaries and, in fact, actively hold themselves out as such. It has been heartening to see that both the Obama Administration in its White Paper, as well as Congressman Kanjorski in the legislation that he introduced last week explicitly state that broker-dealers who provide investment advice should be treated as fiduciaries. Having this codified in legislation will be helpful.*

The confusion masks the real danger – which is that investors may receive advice and not understand that the broker-dealer or its registered representative did not have the high standard of a fiduciary duty to put their interests first and to disclose certain conflicts.

- Commissioner Aguilar

*This proposal furthers investor protection in several ways. Up front, the burden will be on the broker-dealer, just as it now is on the investment adviser, to actively put the client's interest above his or her own and to affirmatively eliminate or mitigate any possible conflicts of interest. A fiduciary standard provides certainty to investors that the person sitting across the table must provide advice that is transparent and in their best interest. You often hear that investors are confused about who is providing them with investment advice, whether it is an adviser or a broker-dealer. The confusion masks the real danger — which is that investors may receive advice and not understand that the broker-dealer or its registered representative did not have the high standard of a fiduciary duty to put their interests first and to disclose certain conflicts.*

*By extending the fiduciary standard to broker-dealers who provide investment advice, Congress would reduce regulatory arbitrage, and this would allow for consistent regulatory oversight of the same conduct. Moreover, it would enhance the ability of the Commission to enforce this standard going forward. It also would establish a principle focused on how a business interacts with investors, rather than on how a business may be organized — whether as a broker-dealer or investment adviser.*

## **A Shared Responsibility: Preserving the Fiduciary Standard – March 26<sup>th</sup>, 2010**

Link: <http://www.sec.gov/news/speech/2010/spch032610laa.htm>

Quote discussing the SEC's role in strengthening observance of the fiduciary standard:

*In addition to ensuring that the fiduciary standard is preserved in any legislation, the Commission, of course, must work to ensure that the fiduciary standard is consistently observed in the industry. No standard, not even the fiduciary standard, has teeth unless it is properly implemented and enforced. One of the ways by which the SEC monitors the application of the fiduciary standard is through inspections and examinations conducted by the Office of Compliance Inspections and Examinations ("OCIE"). And, for most of you, OCIE is your primary point of interaction with the SEC. Thus, I would like to speak for a few minutes about how OCIE is changing.*

(Aguilar then goes on to discuss at length the OCIE and its implications...)

**[T]he Commission, of course, must work to ensure that the fiduciary standard is consistently observed in the industry. No standard, not even the fiduciary standard, has teeth unless it is properly implemented and enforced.**

**- Commissioner Aguilar**

## Protecting Investors by Requiring that Advice-Givers Stay True to the Fiduciary Framework – April 29<sup>th</sup>, 2010

Link: <http://www.sec.gov/news/speech/2010/spch042910laa.htm>

Quotes advocating for legislation for reform on fiduciary accountability and outlining of how, when this is not adhered to properly, it hurts investors:

*... I am supportive of regulatory reform legislation that would strengthen the investor protection regime that currently exists and that results in enhanced protections and flexible authority to regulate an unforeseeable future. This should not become an opportunity to roll back long-held investor protections or create opportunities for regulatory arbitrage.*

*Today, I am going to concentrate my remarks on the following:*

- *Congress should mandate that all providers of investment advice should be fiduciaries;*
- *I am going to discuss a snapshot of certain of the current proposals in Congress; and*
- *I will urge the SEC to move forward in rectifying previous regulatory inaction.*

*... An issue that illustrates this is the discussion around extending the fiduciary duty that underlies the investment adviser regulatory framework to broker-dealers who provide investment advice. This is the ultimate investor protection issue — because the harm to investors is real if broker-dealers giving advice are not held to the fiduciary standard and fail to put their client's interests before their own.*

**Currently broker-dealers are providing investment advice without any requirement that they serve as fiduciaries. In other word, broker-dealers are being permitted to end-run the Advisers Act.**

**- Commissioner Aguilar**

*The fiduciary standard has served advisory clients well for many years and it should be the governing standard whenever investment advice is provided. If you are giving investment advice to an investor, regardless of the title on the business card, you should always be bound to do so in the best interests of the client. While the scope of service may vary between clients, the standards of loyalty and care in providing that service should not.*

*Currently broker-dealers are providing investment advice without any requirement that they serve as fiduciaries. In other words, broker-dealers are being permitted to end-run the Advisers Act. While brokers are required by current law to make certain disclosures about securities that are offered to investors, they are not required to make disclosures about certain of their own conflicts of interest. As a consequence, investors are*

*susceptible to receiving tainted advice from broker-dealers and they will have no way of knowing that the advice was tainted by an undisclosed conflict.*

*Because broker-dealers are not fiduciaries, investors are not required to be informed of possible conflicts that may affect the advice they receive...*

## **Statement in Support of Extending a Fiduciary Duty to Broker-Dealers who Provide Investment Advice – May 11<sup>th</sup>, 2010**

Link: <http://www.sec.gov/news/speech/2010/spch051110laa.htm>

Quote represents the entire speech (as it is short), which showcases Aguilar's strong support for fiduciary principles to be adhered to:

*I unequivocally support the extension of a fiduciary duty to broker-dealers who provide investment advice. It has come to my attention that an excerpt from one of my speeches has been taken out of context to indicate otherwise.*

*I am issuing this statement to be clear as to my position — it is in the best interests of investors and our markets for broker-dealers who provide investment advice to be held to the fiduciary standard that is currently applied to investment advisers. I have consistently advocated this view.*

*Congress passed the Investment Advisers Act of 1940 to protect America's investors from advice-giving intermediaries who have incentives to conceal conflicts and sell investors products that, while suitable, may not be in their best interests. Broker-dealers who provide advisory services to investors should be held to the same fiduciary standard as investment advisers. The fiduciary standard will require them to act in their clients' best interests.*

*Currently, investors are receiving investment advice from broker-dealers who are not fiduciaries. This has serious and real consequences for investors who may not receive advice that is in their best interest. Moreover, investors may not be told that the broker-dealer registered representative sitting across from them may receive undisclosed compensation from the investment option he or she just recommended.*

**[I]nvestors are receiving investment advice from broker-dealers who are not fiduciaries. This has serious and real consequences for investors who may not receive advice that is in their best-interest.**

**- Commissioner Aguilar**



*In my speech delivered March 26, 2010, I also spoke about the need for Congress to allow the SEC to be self-funded. Unlike almost every other financial regulator, the SEC remains without a consistent funding stream. Although the lack of self-funding has imposed challenges on the SEC, the SEC has been and remains a staunch protector of investors. The SEC is the only securities regulator with the necessary experience in dealing with the principles-based regime of the Investment Advisers Act of 1940 and has a long history of bringing cases against fiduciaries that have breached their fiduciary duties to their clients. In fact, the SEC has administered this regime for decades. No other regulator or SRO has this experience.*

*I support legislation to protect investors and support extending the fiduciary duty to broker-dealers who provide investment advice.*

## **Financial Regulatory Reform: The SEC Moving Forward – September 21<sup>st</sup>, 2010**

Link: <http://www.sec.gov/news/speech/2010/spch092110laa.htm>

Quote highlighting the fact that fiduciary duty should be applied whenever investment advice is given, even by broker-dealers:

*Another area in which differing standards apply without good reason is in the duties required of those who provide investment advice to investors. Currently, if a broker-dealer and an investment adviser provide exactly the same advice to the same investor, the duties and responsibilities to the investor can differ simply as a result of the title on the industry professional's business card. It is time that we applied the same standard, that of a fiduciary, to both kinds of professionals. The fiduciary standard — requiring undivided loyalty, reasonable care and good faith to the investor-- has served advisory clients well for many years and it should be the governing standard whenever investment advice is provided. Moreover, investors already believe that their financial advisor, whether an investment adviser or a broker-dealer, has a duty to put their interests first. A recent survey demonstrated that investors don't understand that this is not true.*

## **Doing the Right Thing: Compliance That Works for Investors – April 18<sup>th</sup>, 2013**

Link: <http://www.sec.gov/News/Speech/Detail/Speech/1365171515784>

Quotes talking explicitly about fiduciary duty and compliance to such standards:

*And, to state the obvious, management must also provide the firm's employees with the necessary tools and resources to fulfill their compliance functions, such as hiring the right people, developing effective compliance controls, and designing appropriate policies and procedures that take into consideration the firm's fiduciary obligations to its clients.*

*The SEC has long focused on requiring a strong compliance culture at investment advisory firms. Going as far back as 1939 and culminating with the passage of the Investment Advisers Act of 1940 (“Advisers Act”), the Commission has always recognized the advisers’ broad fiduciary duty to act in the best interest of their clients and the need to address all conflicts of interest between advisers and their clients...*

*... Part of this requirement [of section 204A of the Advisers Act] is that investment advisers must adopt written code of ethics that sets forth a standard of business conduct for its employees that reflects the adviser’s fiduciary obligations. The code of ethics must require, among other things, compliance with the federal securities laws by the advisers’ employees, review of personal securities transactions, and reporting of violations to the chief compliance officer...*

*... Let me conclude by saying that the most important thing to remember about being an investment adviser is that you are ultimate fiduciaries to your clients. And one of the cornerstones of such a responsibility is an effective and robust compliance program that is embedded into an entity’s investment culture from top to bottom.*

*Building a strong culture of compliance is important, especially when the success of your business depends largely on investor trust and confidence. A compliance program that focuses on investor protection also protects your business. This is true because the potential costs of serious compliance failures and violations of the federal securities laws can be much higher than any sanctions imposed by regulators.*

## “Seeing Capital Markets Through Investor Eyes” – December 5<sup>th</sup>, 2013

Link: <http://www.sec.gov/News/Speech/Detail/Speech/1370540451723>

Quote underpinning Aguilar’s understanding of the importance of fiduciary duty:

*I was delighted when I was asked to speak to you about investor protection. As soon as I became a Commissioner, I began to speak out about the need to put investors first. I cannot think of a more relevant issue for an SEC Commissioner. I think each item on the Commission’s agenda should be evaluated based on how it impacts investors—particularly retail investors.*

**[T]here are many issues of significant concern to investors – for example, the importance of applying the same fiduciary standard to both investment advisers and broker-dealers when they provide personalized investment advice...**

**- Commissioner Aguilar**



*The focus on investors is fundamental—simply stated, investors provide the capital that allows companies to grow and expand and to hire more workers. It is investors who are the real “job creators” in our economy. As such, it is in the country’s best interest that we ensure that there is an investment environment that works for investors, particularly the retail investors that live and work on Main Street.*

*I recognize that there are many issues of significant concern to investors—for example, the importance of applying the same fiduciary standard to both investment advisers and broker-dealers when they provide personalized investment advice, concerns regarding audit quality and the independence and skepticism of auditors, and the need to restore confidence in our financial system by continuing to work on implementing many long-overdue requirements of the Dodd-Frank Act.*

## **Evaluating Pension Fund Investments Through The Lens Of Good Corporate Governance – June 27<sup>th</sup>, 2014**

Link: [http://www.sec.gov/News/Speech/Detail/Speech/1370542193403#\\_ednref27](http://www.sec.gov/News/Speech/Detail/Speech/1370542193403#_ednref27)

Quote with references to fiduciary obligations:

*Pension funds can engage with their portfolio companies in several ways, for example, through informal discussions with the company’s board and management, or through the formal process of voting your shares and by submitting shareholder proposals for consideration at the company’s annual meetings.*

*Usually, for pension fund trustees and asset managers, the way you normally communicate with your companies is by exercising the power to vote the shares you own. In fact, voting the shares is one of your fiduciary obligations. As the Department of Labor has stated, “the fiduciary act of managing [fund] assets [that] are shares of corporate stock ... include[s] the voting of proxies [relating] to those shares of stock.*

## **Advocating for Investors Saving for Retirement – February 5<sup>th</sup>, 2015**

Link: <http://www.sec.gov/news/speech/advocating-for-investors-saving-for-retirement.html>

Quote highlighting the need for investors to be knowledgeable about their investments:

*There are several reasons why many Americans fail to plan for retirement, but one obvious reason relates to their lack of knowledge or being confused about what to do. For example, a recent report found that only 20% of Americans could answer basic questions on retirement literacy. The survey tested knowledge in several areas of retirement income preparedness, such as knowledge of investment products and preserving assets in retirement. This lack of knowledge has important consequences for*

*all Americans planning for retirement, as investment products are becoming increasingly complex and information about them, at times, can be very opaque.*

*Even those investors diligently saving for retirement may not have the information they need. Indeed, investment knowledge is becoming more important, as employers have moved from defined benefit plans toward defined contribution plans. The growth in the popularity of 401(k) plans requires more Americans to make their own investment decisions for retirement, while at the same time addressing threats to their retirement nest eggs—such as inflation and health care costs. Accordingly, the questions then become—“Are Americans able to make informed investment decisions—do they have the critical information they need?”*

*As Americans plan for retirement, it’s important that they have adequate and understandable information about their investments.*

## Commissioner Daniel M. Gallagher's Commentary on Fiduciary Duty and Investor Protection

### Introduction, Context, and the Institute's Perspective

Commissioner Gallagher has served at the SEC since he was sworn in on November 7, 2011. While supporting fiduciary duty as it currently applies to investment advisors, he is not a proponent of a uniform, rigorous fiduciary standard for broker-dealers and investment advisors alike. Found below are highlights of his speeches regarding fiduciary duty.

### Speeches in Chronological Order (2012-2015)

**Forward note:** There are many in-text citations which appear in Commissioner Gallagher's original public statements, but are not included in the quotes below for clarity purposes.

### Keynote Address at the National Society of Compliance Professionals National Meeting – Oct. 23, 2012

Link: <http://www.sec.gov/News/Speech/Detail/Speech/1365171491556>

Quotes highlighting Gallagher's belief in the importance in understanding why broker-dealers and investment advisors are regulated distinctly:

*In January 2011, the Commission, with Commissioners Casey and Paredes dissenting, issued a staff report on a study, conducted pursuant to Section 913 of the Dodd-Frank Act, of the effectiveness of the existing regulatory standards of care that apply when brokers and investment advisers provide personalized investment advice to retail customers. In addition to mandating that study, Section 913 authorized, but did not require, the Commission to adopt rules establishing a duty of care for brokers identical to that which applies to investment advisers – in other words, a uniform fiduciary duty for brokers and investment advisers – and to undertake further efforts to harmonize the two regulatory regimes.*

*Earlier this month, at SIFMA's Market Structure Conference, I noted that in order to address the market structure issues we currently face, we need to understand not just the present state of affairs, but also how things came to be the way they are today – the evolution of law, regulation and market practices. I believe the same principle should apply in the context of considering harmonizing our rules imposing conduct requirements on brokers with our rules that do the same for investment advisers. It's important to understand the reasons why Congress decided over 70 years ago to regulate investment advisers through the Investment Advisers Act of 1940, which was*

*separate and distinct in time, form, and substance from the Securities Exchange Act of 1934 that established a regulatory framework for brokers and dealers...*

(Gallagher details the history of how investment advisers and brokers came to be regulated separately)

*...The Advisers Act, on the other hand, appears to have been largely the by-product of an SEC study conducted pursuant to Section 30 of the Public Utility Holding Company Act of 1935, which neither contemplated federal regulation of investment advisers nor, for that matter, referenced “investment advisers” in its text. Section 30 directed the Commission to conduct a study of the “functions and activities of investment trusts and investment companies” – now generally referred to as mutual funds – “and the influence exerted by interests affiliated with the management of such trusts and companies upon their investment policies.” Incidental to its main study, the Commission also undertook a limited review of the investment adviser profession after finding that some advisers had investment trusts and investment companies as clients. The resulting report included only a brief discussion of what the Commission referred to as “some of the problems which appear to be present or inherent” in the investment adviser industry, such as, among other things, the emergence of “tipster” organizations and the use of “heads I win, tails you lose” profit-sharing arrangements.*

*In response to the Commission’s full report, beginning in March 1940, the Senate held four weeks of hearings on companion bills in the House and Senate to regulate investment companies and investment advisers. During those hearings, the industry emphasized how investment advisers differed from brokers. For example, industry representatives testified that the bona fide investment adviser typically did not act as a broker in securities transactions involving clients, charge transaction-based fees, or take custody of securities or cash balances, all of which might bias the adviser’s judgment and advice. In contrast, they described the continuous, comprehensive, and personalized nature of the advisory services they provided, and explained that the foundation of their profession rested on a relationship of trust, confidence, and confidentiality with their clients. Ultimately, the industry opposed the investment adviser bill, expressing its concern that strict federal regulation of investment advisers, particularly through the anticipated use of the Commission’s enforcement powers, could potentially destroy the fundamental nature of the adviser-client relationship.*

*In response to the industry’s initial opposition, Congress directed the Commission and the industry to work together on a draft proposal for the regulation of investment advisers. The proposed bill that resulted from this effort was, with some changes, enacted into law as the Investment Advisers Act. The Advisers Act in its original form – only 21 sections, covering a mere three pages in the Congressional Record – was later described by the Commission in a 1988 report to Congress on financial planners as “modest in the regulatory scheme it imposed.” For the first 20 years of its existence, the basic purpose of the Advisers Act was considered to be a “compulsory census” of the*

*investment adviser industry through a registration and reporting provision that was modeled on a similar provision in the Exchange Act for OTC broker-dealers...*

*...Yet, the Advisers Act did not clearly define a standard of care owed by investment advisers to their clients, let alone use the term “fiduciary duty.” In a 1963 case, however, the Supreme Court interpreted the Advisers Act as, in fact, establishing federal fiduciary standards for investment advisers....*

*...Aside from its registration provisions, the Advisers Act shared little in common with the regulatory regime then applicable to broker-dealers. Notably, Congress explicitly exempted from the Advisers Act brokers who provided investment advice that was merely incidental to brokerage transactions for which they received only brokerage commissions. Unlike the legislation establishing a regulatory scheme for brokers, the Advisers Act contained few substantive provisions governing conduct. Moreover, despite the fact that voluntary self-regulation was discussed in the Commission’s 1939 report to Congress on investment advisers as well as during the Congressional hearings on the proposed legislation, Congress did not provide for the creation of self-regulatory organizations for investment advisers. As a result, whereas the regulatory regime for broker-dealers has been for decades based on SRO oversight and substantive rules of conduct, the investment adviser industry has evolved over time under a more principles-based disclosure regime grounded in the fiduciary duty owed by advisers to their clients...*

*...The convergence of the roles of brokers and investment advisers has led to calls for new efforts to harmonize the two regulatory regimes, as exemplified by the new mandates and regulatory authority set forth in Section 913 of Dodd-Frank. As we review today’s landscape and consider whether and to what degree to harmonize the broker-dealer and investment adviser regulatory regimes, however, we need to be cognizant not only of the very different histories of those regimes but also of the fact that we’re not the first to consider the issue. In striving to obtain the best outcome for investors, whether clients of broker-dealers, investment advisors, or both, we should bring to bear our historical experience and approach the subject with a certain regulatory humility that places our efforts in the context of eight decades of securities regulation. And it is important to note that the Commission is not compelled to promulgate rules pursuant to Section 913 – Congress granted the Commission authority to write rules, but left it to our discretion. Any rulemaking pursuant to Section 913 must, then, be supported by Commission findings that such rules are necessary, as well as a detailed understanding and analysis of the economic consequences of such rules.*

## Remarks at *The SEC Speaks* in 2015 – Feb. 20, 2015

Link: <http://www.sec.gov/news/speech/022015-spchcdmg.html>

Quote expressing Gallagher's opinion on how applying fiduciary duty to broker-dealers would not be appropriate:

*In October 2010, the Department of Labor issued a proposal that would have broadly defined the term "fiduciary" for purposes of the DOL-administered Employee Retirement Security Act of 1974, or ERISA, as a person who provides investment advice to plans for a fee or other compensation. That proposal, which would have radically altered well-established law, was based on DOL's desire to take action against investment professionals who DOL believes provide inaccurate, misleading, or biased advice.*

*The proposal generated much comment, most of it negative. One of the main criticisms of the proposal is that it would have severely limited investor access to qualified investment advice and investment products. DOL withdrew the proposal in 2011, but like so many bureaucratic dreams, it was only deferred, not denied. Based on recent reports, the re-proposal will be published soon.*

*Now, I have not seen the re-proposal. And given the SEC's comprehensive oversight authority with respect to the investment advisers and broker-dealers who would be impacted by it, you might find that curious. It's even more curious given that Section 913 of Dodd-Frank mandated that the SEC study the effectiveness of the existing regulatory standards of care for brokers and advisers, a study that was in progress when DOL first published its proposed rule in 2010.*

**Then-Commissioners Casey and Paredes issued a statement of opposition to the study, reasoning – very persuasively, I would add – that the Study did not adequately articulate or substantiate the problems that would purportedly be addressed through additional regulation.**

- Commissioner Gallagher

*The SEC staff published the Section 913 Study in January 2011. The study recommended a uniform fiduciary standard for investment advisers and broker-dealers who provide investment advice about securities to retail customers. The standard recommended would be no less stringent than the current fiduciary standard for investment advisers. Then-Commissioners Casey and Paredes issued a statement of opposition to the study, reasoning – very persuasively, I would add -- that the Study did not adequately articulate or substantiate the problems that would purportedly be addressed through additional regulation. They also pointed out another fundamental*



*flaw in the study – that it did not consider whether its recommendations could adversely impact investors. Last year, my friend and colleague, Commissioner Piwowar, similarly noted that a uniform fiduciary duty could actually harm retail investors and expressed his concern that it could limit financial advisory options or preclude investors from receiving investment advice altogether.*

*Since the publication of the Section 913 Study, the Commission has formally requested information, in particular quantitative data and economic analysis, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers.*

*Yet, despite all the work the SEC Staff has undertaken on the subject, not to mention the Commission's decades of history in regulating broker-dealers and investment advisers and overseeing their disclosures relating to conflicts of interest, DOL has not formally engaged the Commissioners, at least not this Commissioner, on its fiduciary rulemaking process and the impact it may have on investors...*

*...Although, as I noted, I haven't seen the DOL's re-proposal, thanks to a White House "memo" shockingly "leaked" to the press earlier this year, I can make an educated guess at what might be included. Although nominally focused on the subject of DOL's draft rule, this memo took aim at every professional engaged in selling securities to investors.*

*Let's start with some of the claims the White House memo makes. First, the memo states that "consumer protections for investment advice in the retail and small plan markets are inadequate." This overarching statement is not accompanied by any analysis or study of the current protections investors receive from the regulatory oversight of brokers and investment advisers by the SEC and the SROs - in fact, it blatantly ignores this comprehensive regulatory oversight. Indeed, the memo manages to avoid any mention of either the SEC or FINRA!*

**“[T]he current regulatory environment creates perverse incentives that ultimately cost savers billions of dollars per year”...there are SEC and SRO rules directly addressing [these] so-called perverse incentives...**

**- Commissioner Gallagher**

*Second, the memo states that "the current regulatory environment creates perverse incentives that ultimately cost savers billions of dollars a year." I am not going to be drawn into a debate about the studies the memo selectively cites to support this conclusion. But I will point out that there are SEC and SRO rules directly addressing the so-called perverse incentives referenced to in the memo. Among other things, these rules require clear disclosure to investors about payments and fees – including incentive fees – prohibit the use of manipulative, deceptive or fraudulent practices, and*

*require significant diligence about investors and their needs. These rules also limit performance fees and regulate advertising.*

*Third, the memo states that “the current regulatory environment allows fund sponsors and advisory service firms to create incentives for their advisors to recommend excessive churning . . . of retirement assets and to steer savers into higher cost products with financial payoffs for the advisor.” Far be it from me, as a mere SEC Commissioner, to second guess the White House securities law experts, but I do feel obligated to point out that our rules expressly prohibit brokers from churning client accounts, and the SEC and SROs have sophisticated tools designed to monitor for such activity.*

*Finally, the memo states “academic research has clearly established that conflicts of interest affect financial advisors’ behavior and that advisors often act opportunistically to the detriment of their clients because of payments they receive from product providers.” This statement, like the others, ignores the existence of the comprehensive oversight and disclosure regime specifically designed to address these underlying conflicts of interest.*

*Taking a step back, there are two general approaches to regulating conflicts of interest. The first is simply to ban them or, as the DOL may attempt, to effectively ban them by issuing rules full of so many ill-defined hoops and hurdles that any reasonable regulated entities would throw their hands up in defeat. The second is to mitigate potential risks associated with conflicts through market rules, disclosure, compliance and enforcement—the approach taken by the securities laws now.*

*The White House memo is clearly premised on a belief that the status quo is deficient. But, it ignores the main reason for the mitigation-based approach to conflicts and related disclosures: Investors benefit from choice; choice of products, and choice in advice providers. This is something the nanny state has a hard time comprehending. If the DOL sticks with its approach to ban or effectively ban conflicts, entire categories of products and services that are now available to investors could disappear. And, tragically, some commenters say the negative impact of this loss will be borne by low and moderate-income workers...*

**I do not mean to imply that the SEC’s regulation of investment professionals is perfect. But, I believe that the model is not fundamentally broken.**

**- Commissioner Gallagher**

*...To be clear, I do not mean to imply that the SEC’s regulation of investment professionals is perfect. But, I believe that the model is not fundamentally broken. And I am greatly concerned that much of the debate on these issues seems to assume that the “fiduciary duty” is some sort of talismanic protection that can overcome any competing*

*regulatory concerns. All too often, this is the approach taken by those who simply do not know how the fiduciary duty works in practice. They do not understand or choose to ignore the limitations of the fiduciary duty...*

*...In closing, while being a “fiduciary” means acting in the best interest of the client, it does not mean that all models where financial professionals are not fiduciaries are flawed. It also does not mean that labeling a financial professional as a fiduciary will solve the problem, especially when those problems have not been sufficiently identified and their causes studied. One size fits all regulation, in practice, tends to end up as one size fits none. And when all is said and done, it means investors are presented with fewer choices and higher prices. Conflicts exist, that we cannot deny. But, investors and our markets are better off when we seek to manage those conflicts, through disclosures or otherwise, rather than eviscerating entire business models and the benefits they provide. This is the approach the Commission has taken for over eight decades. It should remain our approach for the next eight decades and beyond.*

## Comment Letter on the Department of Labor Proposed Rule on Conflicts of Interest and Fiduciary Duty – July 21, 2015

Link: <http://www.sec.gov/news/speech/2015/gallagher-dol-comment-ttr-7-21-15.pdf>

*Dear Secretary Perez:*

*I submit this comment letter on my own behalf and representing my own views in connection with the Department of Labor's ("DOL") proposed rules addressing the definition of "fiduciary," conflict of interest requirements for retirement investment advice, and related proposed exemptions and amendments ("the Fiduciary Proposal").*

*It is clear to me that the DOL rulemaking is a fait accompli and that the comment process is merely perfunctory, yet I feel compelled to weigh in on the Fiduciary Proposal because I am convinced that the rule, when finalized, will harm investors and the U.S. capital markets. The proposal is grounded in the misguided notion that charging fees based on the amount of assets under management is superior in every respect and for every investor to charging commission based fees. It brazenly dismisses both suitability as a proper standard of care for brokers and the FINRA arbitration system as a mechanism to resolve disputes between financial professionals and their clients- good for plaintiffs' lawyers, bad for investors.*

*Broker-dealers utilizing a commission-based fee structure will find it difficult, if not impossible, to navigate the labyrinth of prohibitions and exemptions contemplated by the proposal, and many will make the unfortunate- yet entirely rational- choice to stop servicing certain retirement accounts. High net worth broker-dealer clients will be moved into fee-based advisory accounts and will pay a premium to the existing commission structure. Less well-heeled customers will be "fired" by their brokers or jettisoned to robo-advisers. I find it very convenient that the disparate impact the proposed rule will have on low to moderate income workers has received scant attention from supporters of the proposal. Like so many other bad government policies, the DOL rule will affirmatively harm those it ostensibly sets out to help.*

*Proving that the nanny-state is alive and well, DOL is proposing to substitute its judgment for that of investors in deciding the type of financial professional and fee structure all investors should use when investing their retirement savings. In doing so, it has ignored the benefits to investors of a disclosure-based approach to mitigating potential conflicts of interest. Investors benefit from choice: choice of products, choice in advice providers, and choice in making decisions for themselves.*

*Since DOL first proposed changes to its fiduciary and conflict of interest rules in 2010, the industry has been scrambling to find a workable path forward. One particularly popular notion has been that a Securities and Exchange Commission ("SEC") rulemaking under Section 913 of the Dodd-Frank Act could stave off an ill-conceived DOL rule. Indeed, many observers were delighted and encouraged by remarks made by SEC Chair Mary Jo White in March of this year announcing her view that the Commission should move forward with such a uniform fiduciary duty rule.*

*Unfortunately, those who believe that the SEC can stave off the heavy hand of DOL are chasing fool's gold. Section 913 gives the SEC the authority to conduct rulemaking with respect to broker-dealers' standard of care when providing personalized investment advice about securities to a retail customer. Any such standard "shall be no less stringent than the standard applicable to investment advisers" and "any material conflicts of interest shall be disclosed and may be consented to by the customer." Moreover, Section 913 makes clear that commission-based fees must be permissible under any SEC rules.*

*Brokers could comply with an SEC rule under Section 913 while continuing to charge commissions and using disclosure to mitigate conflicts of interest. However, compliance with an SEC fiduciary rule does not mean compliance with the DOL rule. In the event that the Commission moves forward with a Section 913 rulemaking, the industry will most likely end up with two incredibly burdensome and redundant rules. It would have been possible to conduct a coordinated rulemaking process, but to date the DOL's actions, and the substance of the DOL Fiduciary Proposal, reflect a lack of concern for the Commission's views on these issues.*

*You have stated that you and Chair White have extensively discussed the Fiduciary Proposal? DOL also maintains that the staffs of the two agencies have worked very closely throughout the drafting process. As you know, I was not included in any of these conversations. From a distance- a place where a presidentially-appointed SEC Commissioner should not be in this context- it appears that any interaction between staffs at DOL and the SEC and all of these discussions with Chair White have borne no fruit. Strikingly, the Fiduciary Proposal does not contemplate or even mention potential SEC rules or the SEC's existing regime for regulating broker-dealers and investment advisers. If the DOL were actually serious about working together with the SEC on an implementable standard, it could have - and should have- included in its proposal some type of substituted compliance mechanism, in which compliance with an SEC fiduciary standard would satisfy the DOL rules. Instead, DOL is choosing to substitute its judgment for that of the expert regulator of broker-dealers, in the process denying investors a choice in products, services, and financial professionals.*

*There was a different path that the DOL could have taken. In conjunction with the SEC, the DOL could have pursued a disclosure-based solution to the alleged excessive fee problem. Indeed, the Commission has employed a combination of tailored disclosure and market forces for eight decades to ensure that investors can make informed investment decisions. In the context of broker fees, fairness is usually in the eye of the beholder- i.e., the investor. Before rolling out another draconian proposal, the DOL could- and should have- engaged the SEC in a dialogue about fee disclosure. Indeed, the Commission has been debating this issue for over 12 years, and despite a failed attempt at broker point of sale disclosure in 2003, the idea of an appropriately-tailored point of sale disclosure regime is still worthy of pursuing. Perhaps if the Commission had not been so busy over the last five years rotely implementing nonsensical Dodd-Frank mandates such as the conflict mineral disclosure rule (which, it turns out, was proposed right about the same time as the 2010 DOL fiduciary proposal), the agency could have been focusing on key issues like broker fees.*

*DOL should scrap the Fiduciary Proposal and start working in a meaningful way with the Commission to address the DOL's concerns about broker fees for retirement accounts. The Fiduciary Proposal will harm investors, plain and simple, and an SEC rulemaking under Section 913 of Dodd-Frank will only make a bad situation worse. Let's end the rampant nanny-statism that is motivating both of these rulemakings and instead focus on a disclosure regime that empowers investors and allows brokerage firms to continue to offer a menu of services to all types of investors, not just the affluent. Despite the rancor surrounding this debate, it is my hope and belief that the DOL and SEC can find a reasonable path forward.*



## Appendix

### **Chairman Mary L. Schapiro's Mentions of Fiduciary Duty in 2009**

Address before the New York Financial Writers' Association Annual Awards Dinner – June 18, 2009  
<http://www.sec.gov/news/speech/2009/spch061809mls-2.htm>

Address to Financial Services Roundtable — 2009 Fall Conference – September 24, 2009:  
<http://www.sec.gov/news/speech/2009/spch092409mls.htm>

Remarks at the University of Rochester's Presidential Symposium on the Future of Financial Regulation – October 10, 2009: <http://www.sec.gov/news/speech/2009/spch101009mls.htm>

"The Road to Investor Confidence" – October 27, 2009:  
<http://www.sec.gov/news/speech/2009/spch102709mls.htm>

"The Consumer in the Financial Services Revolution" – December 3, 2009:  
<http://www.sec.gov/news/speech/2009/spch120309mls.htm>

### **Chairman Mary L. Schapiro's Mentions of Fiduciary Duty in 2010**

Remarks at the CCO Outreach National Seminar – January 26, 2010:  
<http://www.sec.gov/news/speech/2010/spch012610mls.htm>

Keynote Address at the Compliance and Legal Society of the Securities Industry and Financial Markets Association 2010 Annual Seminar – May 6, 2010:  
<http://www.sec.gov/news/speech/2010/spch050610mls.htm>

Remarks at CFA Institute 2010 Annual Conference – May 18, 2010:  
<http://www.sec.gov/news/speech/2010/spch051810mls.htm>

Opening Statement at the SEC Open Meeting – June 30, 2010:  
<http://www.sec.gov/news/speech/2010/spch063010mls.htm>

Remarks at the National Conference of the Society of Corporate Secretaries and Governance Professionals – July 9, 2010: <http://www.sec.gov/news/speech/2010/spch070910mls.htm>

Moving Forward: The Next Phase in Financial Regulatory Reform – July 27, 2010:  
<http://www.sec.gov/news/speech/2010/spch072710mls.htm>

Brodsky Family Lecture at Northwestern University School of Law – November 9, 2010:  
<http://www.sec.gov/news/speech/2010/spch110910mls.htm>