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on

Legislative Proposals to Relieve the Red Tape Burden

on Investors and Job Creators

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Chairman Garrett, Ranking Member Waters, members of the Subcommittee, thank you for the opportunity to appear before you today to discuss legislative proposals being considered by the Subcommittee. It is an honor and a privilege to appear before the Subcommittee today.

I am the Founder and President of Fund Democracy, a nonprofit investor advocacy group, and a Jessie D. Puckett, Jr., Lecturer and Associate Professor of Law at the University of Mississippi School of Law. I am also a Vice President of the financial planning firm, Plancorp LLC; a member of the Public Company Accounting Oversight Board's Investor Advisory Group; and an Accredited Investment Fiduciary. I was formerly a member of the SEC's Investor Advisory Committee and chaired its Investor as Purchaser Subcommittee; an Assistant Chief Counsel in the SEC's Division of Investment Management; and an attorney in the securities practice of Wilmer, Cutler & Pickering (now WilmerHale).

This testimony is based on my general experience over a number of years as an investor advocate, journalist, academic, regulator, financial planner, private practitioner and expert witness and consultant. I have been engaged in financial services regulatory issues from a variety of perspectives and attempt to provide testimony that reflects the interests of investors, diverse views of various constituents, and the practical exigencies of real-world legal practice and compliance.

In this written submission, I have focused on the Wagner Fiduciary Discussion Draft, which I refer to as the "Act." Part I of my testimony addresses the cost-benefit provisions contained in Sections 15(k)(1) – (3) of the Act (for clarity, I refer to the "Sections" as they would appear in the Exchange Act, as amended). Part II addresses the coordination provision in Section 15(k)(5). Section 15(k)(4)'s customer confusion provision is discussed in Part III, and Section 15(k)(6)'s investment adviser rulemaking provision is discussed in Part IV.

In summary, the Act's cost-benefit provisions would improperly constrain the SEC's ability to do what Congress asked it to do by authorizing rulemaking under Section 913 of the Dodd-Frank Act. Section 913 commanded the SEC to consider whether broker-dealers, like investment advisers, should be subject to a "best interest of the customer" standard when providing personalized, retail investment advice. The Act would substantially impede the SEC's ability to analyze this option, much less to propose a rule.

The interagency coordination of rulemaking provision, to the extent that the "conflicts" it addresses are limited to actual conflicts, is appropriate. However, the provision appears to reflect an ultimate goal of preventing the Department of Labor from moving forward with a fiduciary proposal that may impose more stringent requirements than SEC rules impose. First, it is the employee benefits law created by Congress that mandates more stringent requirements for retirement plan investments. Second, the Act's coordination provision may reflect concerns regarding the DOL's initial fiduciary proposal, but the DOL has withdrawn that proposal and indicated that it plans to issue a substantially revised re-proposal in a matter of months. Before acting on the DOL's new proposal, Congress should at least determine what the DOL is proposing.

Finally, the customer confusion and investment adviser regulation are fundamentally flawed. The customer confusion provision effectively provides that investors are to be denied the benefit of a fiduciary rule for broker-dealers unless they can demonstrate an improved understanding of the legal duties that apply to broker-dealers. This provision suggests that confused investors are the problem. In fact, the problem is caused by rules that apply different standards to different financial professionals providing the same services.

The investment adviser rulemaking provision essentially requires that the Commission impose unrelated regulations on investment advisers, regardless of

whether such rules are warranted, as a condition of adopting a best interest standard for broker-dealers. The provision appears to be nothing more than a rent-seeking effort by one industry to gain an advantage over another simply by subjecting to them to more rules.

I. Cost-Benefit Provisions

The cost-benefit provisions in Sections 15(k)(1) – (3) of the Act reflect generally appropriate aspirational standards for rulemaking, but as statutory mandates they will adversely affect the SEC's ability to decide how best to exercise its authority under Section 913 of the Dodd-Frank Act. These provisions will distort the integration of cost-benefit analysis into the SEC's rulemaking; further substitute expert agency discretion with inexpert judicial rulemaking; create legal uncertainty; chill necessary rulemaking; generate unnecessary and unproductive litigation; increase the SEC's operating expense and size while impeding its efficient operation; and promote the development of non-uniform, enforcement-based law.

A. The Burdens of Cost-Benefit Requirements

The Act's cost-benefit provisions will create redundancies and confusion that will only impede the SEC's ability to conduct a balanced cost-benefit analysis of the efficacy of fiduciary rules for broker-dealers.[1] SEC rulemaking is subject to a panoply of cost-benefit analysis requirements that already substantially and unnecessarily interfere with the process of efficient rulemaking. Section 2(b) of the Securities Act, Section 3(f) of the Exchange Act, Section 202(c) of the Investment

[1] *See* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America (May 22, 2013) ("The overall effect of the proposed legislation would be to place unreasonable conditions on the Securities and Exchange Commission as it considers whether to raise the standard of conduct that applies to brokers when they give personalized investment advice to retail investors.") *available at* http://www.consumerfed.org/pdfs/CFA-AFR-Wagner-Bill-Opposition-Letter.pdf.

Advisers Act and Section 3(c) of the Investment Company require that the Commission, when adopting rules under those statutes, "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[2] Section 23(a)(2) of the Exchange Act requires that the Commission "consider . . . the impact . . . on competition" and prohibits the adopting of any rule that "would impose a burden on competition not necessary or appropriate in the furtherance of the purposes of [the Exchange Act]." That provision also requires a written statement of the "reasons" for a determination that any [such] burden on competition" is necessary and appropriate in the furtherance of the purposes of [the Exchange Act]." These provisions are themselves substantially redundant statements of the "arbitrary and capricious standard" of review under Section 706 of the Administrative Procedures Act, which provides that a court shall vacate agency rules that it finds, among other grounds, to be "arbitrary, capricious, [or] an abuse of discretion." The operation of this particular standard as a constraint on rulemaking has been repeatedly demonstrated by courts that have vacated SEC rules deemed to be arbitrary and capricious.[3] The arbitrary and capricious standard has repeatedly proved to provide all of the leverage needed to overturn agency rules that do not reflect good cost-benefit analysis.

The Act does nothing to clarify or otherwise improve cost-benefit requirements that already apply to SEC rulemaking. Rather, the Act adds complexity and cost to what is already an overly cumbersome web of rules about rulemaking. It

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[2] The full text of Section 2(b) is as follows:

> Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

[3] *See*, *e.g.*, *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (vacating proxy access rule on arbitrary and capricious grounds and because of failure to conduct adequate cost-benefit analysis); *American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010) (vacating equity-indexed annuities rule on arbitrary and capricious grounds); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (vacating mutual fund rule because of failure to consider costs and alternatives).

repeats requirements that the SEC assess the costs and benefits of any fiduciary rulemaking and creates new, specific lines of analysis – such as section 15(k)(3)'s "harm to investors" inquiry – that add nothing substantive to the SEC's existing procedures. The Act will simply require that yet another piece of analysis be added to any fiduciary rule proposing and/or adopting release that translates the actual cost-benefit analysis conducted by the Commission into yet another redundant legislative framework. The effect on staffing will be to add more hours to the workload of the bevy of lawyers whose primary responsibility is not to develop rules that efficiently regulate the conduct of financial services providers, but to administer rules about rules that regulate rulemaking agencies. These lawyers play an essential role in agency rulemaking, but when their process-based role overwhelms the substantive issues at hand, as legislation such as the Act makes inevitable, government bureaucracy becomes precisely the Orwellian tumefaction that opponents of "red tape" claim to oppose. A former SEC official's assessment of another cost-benefit bill, H.R. 2308, applies equally to the Act:

> the Act would consume vast amounts of SEC staff time with periodic reviews of the existing substantial body of federal securities regulations to find anything deemed "outmoded, ineffective, insufficient or excessively burdensome."[4]

The solution to regulatory red tape is not to expand *infinitum* internal government processes and, consequently, government payrolls so that agencies consume a perpetually increasing share of national resources while creating less and less social value for society. Rather, the solution is to streamline agency processes in order to minimize the role of procedural analysis and maximize the role of substantive analysis. The comments of the official cited above are again apropros:

[4] Hearing before the Committee on Financial Services, House of Representatives at 4 (Sep. 15, 2011) (testimony of Stephen J. Crimmins) *available at* http://financialservices.house.gov/UploadedFiles/091511crimmins.pdf.

> Just as America's businesses need new SEC rules to streamline capital formation and traders need new SEC rules to streamline markets, so also we must give the SEC itself a streamlined process for issuing those rules. The SEC already has to include dozens of pages of detailed cost-benefit and other economic analysis every time it writes a rule, and we don't need to pile on more requirements.[5]

The Act "piles on more requirements" that will expand government while making it less efficient. If Congress wishes to facilitate cost-benefit analysis, then it should begin not by adding to the already byzantine network of administrative shackles, but by streamlining and consolidating cost-benefit and information collection standards so that agencies can focus on the analysis, rather than the analysis of the analysis.

The Act also reflects a popular but erroneous belief that an agency can exhaust every avenue of inquiry that might reasonably lead to a better understanding of a rule's costs and benefits. In fact, regulatory action is invariably based on imperfect information, just as regulation invariably requires the exercise of reasoned judgment in the known absence of information that theoretically could improve the regulatory decisionmaking process.[6] Efficient rulemaking necessarily

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[5] *Id*.

[6] Former SEC Secretary Jack Katz aptly described this misperception in testimony before the full Committee:

> While I have long supported the use of cost benefit analysis as one component of the rulemaking process, I have also believed that the process has limitations that are often overlooked. Cost-benefit analyses are and will always be fundamentally limited. They require estimates of the impact of events that have not yet happened. Simply put, it is difficult if not impossible for any regulator to know what will happen when a regulation is adopted. Capital markets are the reflection of large numbers of individuals making individual decisions. A regulator rarely has the capacity to predict with certainty how individuals or firms will respond to a new rule. If a regulator can't predict the response, it is difficult to accurately quantify the cost of compliance or quantify the value of benefits before one knows how the industry will achieve compliance. The current means of developing cost benefit analysis may be manipulated or fail to take into account facts that may not be readily apparent yet important to the ultimate purpose of a proposed rule.

Id. at 14, *available at* http://financialservices.house.gov/UploadedFiles/091511katz.pdf.

reflects accepting the reality that decisive action is not possible if perfect information is a necessary predicate. The Act will increase the likelihood that the SEC will avoid taking needed regulatory action simply out of fear that its rules will be vacated for having left some cost-benefit stone unturned.[7]

B. Raising the Bar to Guarantee Failure?

As with other cost-benefit bills, it is unclear what problem the Act is intended to solve. Critics claim that SEC rulemaking has not satisfied existing cost-benefit requirements, and there is support for this critique.[8] However, the SEC's past failure to satisfy current standards would logically support legislation designed to bring about such compliance, not to make compliance more difficult. For example, Congress could provide the Commission with the financial resources that it would need to conduct the cost-benefit analysis that the Act requires.[9]

Instead, the Act raises the bar for the SEC's cost-benefit analysis. This approach is the equivalent of addressing a national deficiency in college students'

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[7] *Cf. id.* at 15 (testimony of SEC Chairman Mary Schapiro) (H.R. 2308 "would create a new potential challenge to future rules") *available at http://financialservices.house.gov/UploadedFiles/091511schapiro.pdf*. *See also* Jesse Hamilton, *Dodd-Frank Rules Slow at SEC after Cost Challenge*, Bloomberg (Mar. 5, 2012) *available at* http://www.bloomberg.com/news/2012-03-06/dodd-frank-rules-slow-at-sec-after-court-cost-benefit-challenge.html; Phil Mattingly & Jesse Hamilton, *Broker Fiduciary Rule Delayed by Cost-Benefit Analysis, SEC Says*, Bloomberg BusinessWeek (Jan. 20, 2012) *available at* http://www.businessweek.com/news/2012-01-20/broker-fiduciary-rule-delayed-by-cost-benefit-analysis-sec-says.html; Peter Madigan, *CFTC and SEC Facing Legal Anxiety Over Cost-Benefit Analyses*, Risk Magazine (Oct. 3, 2011) (published under the original headline: *Cost-Benefit Paralysis*) *available at* http://www.risk.net/risk-magazine/feature/2111501/cftc-sec-facing-legal-anxiety-cost-benefit-analyses*.*

[8] *See* Hearing before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, Committee on Oversight and Government Reform, United States House of Representatives (Apr. 17, 2012) (testimony of Mercer Bullard) *available at* http://oversight.house.gov/wp-content/uploads/2012/04/4-17-12-Bullard-Testimony.pdf.

[9] Hearing before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives (May 7, 2013) (testimony of SEC Chairman Mary Jo White) ("The S.E.C.'s current level of resources still presents significant challenges as we seek to keep pace with the growing size and complexity of the securities markets and fulfill our broad mandates and responsibilities.") *available at* http://www.sec.gov/news/testimony/2013/ts050713mjw.htm.

test scores by simply raising the score needed to past the test. The only rational explanation for this approach is that the Act is not intended to improve the SEC's cost-benefit analysis, but rather to ensure that, when the SEC *has* improved its cost-benefit analysis, the cost-benefit bar will have been raised to a point that guarantees failure. It appears that the purpose of pending cost-benefit bills is move standards beyond the SEC's reach so as to make legally sufficient rulemaking almost impossible.

Increasing the complexity and burdens of cost-benefit requirements, rather than addressing a perceived failure to comply with existing requirements, is much likelier to degrade the SEC's capacity to make efficient, effective rules than to improve it. The heightened standards of the Act will make it even more difficult for the Commission to conduct fiduciary rulemaking, just as recently passed H.R. 1062 will make all rulemaking more difficult.[10] The purpose of these bills appears to be to prevent rulemaking altogether.

C. Unintended Consequences

Even if the purpose of the Act is simply to insulate broker-dealers from being subject to a fiduciary duty, the Act will not achieve its goal. Regulatory paralysis invariably has unintended consequences that often impose far greater costs on industry than the costs that industry believes it has avoided by preventing rulemaking. The SEC's inaction, for example, in the face of problems arising during the last decade from analysts' conflicts of interest, mutual funds' use of stale prices and inadequate disclosure of revenue sharing effectively ceded these areas to *de*

[10] *See* Melanie Waddell, *House Passes SEC Cost-Benefit Bill*, AdvisorOne.com (May 17, 2013) (quoting SEC Chairman Mary Jo White, H.R. 1062 will put SEC rules "under constant challenge") *available at* http://www.advisorone.com/2013/05/17/house-passes-sec-cost-benefit-bill; Andrew Ackerman, *House Lawmakers Pass SEC Cost-benefit Bill*, Wall St. J. (May 17, 2013) (OMB statement that H.R. 1062 would "add onerous procedures that would threaten the implementation of key reforms related to financial stability and investor protection.").

facto rulemaking by state attorneys general and other enforcement officials. In each case, the SEC's failure to conduct rulemaking resulted in Balkanized, *ad hoc* lawmaking that left all interested parties (other than litigators) worse off. When critics complain that the SEC rulemaking relies on inadequate cost-benefit analysis, they are often choosing, in effect, that law be made through less efficient, less effective means that are more costly to industry.

It is foolhardy to think that agencies will simply surrender to the rulemaking paralysis that the Act and bills like it would impose. Agency leadership knows that they will be held accountable for fraud that occurs on their watch, regardless of whether Congress is the party responsible for the agency's not adopting rules that would have most efficiently minimized the fraud. Agency leadership accordingly will find other, less efficient ways to fill gaps and resolve inconsistencies in the law. This is precisely what has happened in the fiduciary sphere.

The Commission has brought a series of enforcement actions that, in effect, impose a quasi-fiduciary duty with respect to revenue sharing arrangements.[11] Revenue sharing disclosure is precisely the kind of conflict disclosure that a fiduciary duty would clearly require.[12] Courts have found that the nondisclosure of revenue sharing is not necessarily fraudulent. A fiduciary duty (or targeted conduct rule) therefore is necessary to cause disclosure of the conflict of interest that revenue sharing payments. Instead of rulemaking,[13] the SEC has regulated revenue

[11] *See* Mercer Bullard, *The Fiduciary Study: A Triumph of Substance Over Form?* (citing cases at footnote 41) (forthcoming in Boston University Review Banking and Financial Law) *available at* http://ssrn.com/abstract=1669636). "Revenue sharing" refers to payments by mutual fund investment advisers to brokers as compensation for selling fund shares. *See* Mercer Bullard, *Dura, Loss Causation, and Mutual Funds: A Requiem for Private Claims?* 76 U. Cin. L. Rev. 559, 570 (2008).

[12] *See* Michael Koffler, *The Brave New World of Fiduciary Duty for Broker-Dealers and Investment Advisers*, Sutherland Asbill & Brennan LLP, at 13, 24 (Apr. 2010) (subjecting broker-dealers to a fiduciary duty would require that they disclose the revenue sharing payments) at http://www.investmentadvisor.com/Issues/2010/April-2010/PublishingImages/Envestnet_Fiduciary%20Duty.pdf).

[13] In 2004, the Commission proposed a rule that would have addressed revenue sharing disclosure. It re-proposed the rule in 2005, but has continued to be unable to reach a final resolution on this issue.

sharing through enforcement, essentially bringing a series of enforcement actions against broker-dealers under antifraud rules for conduct that is not necessarily fraud.[14] States, FINRA and private litigants in FINRA arbitration, have also brought revenue sharing claims,[15] thereby creating a multijurisdictional set of rules that should be consolidated in a single, uniform, SEC-promulgated standard. Rulemaking through multijurisdictional enforcement and private litigation creates uncertainty, encourages deception over compliance, and favors product and service providers that are inclined to flout the law. Overly burdensome cost-benefit requirements such as those imposed by the Act will simply drive more regulation into enforcement.

Moreover, cost-benefit gridlock in one agency creates vacuums that other actors will fill. The absence of a fiduciary rule has led FINRA to expand the scope of suitability obligations to include what practitioners have recognized is a quasi-fiduciary standard clothed as a suitability duty.[16] The absence of a fiduciary duty has

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See Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Exchange Act Rel. No. 51274 (Feb. 28, 2005) (re-proposal); Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Exchange Act Rel. Nos. 49148, at note 55 (Jan. 29, 2004) (original proposal). This rulemaking illustrates the kind of regulatory paralysis that the Act will only exacerbate.

[14] *See supra* note 11.

[15] *See*, *e.g.*, *Aucoin v. Gauthier*, 35 So.3d 326 (La.App. 1 Cir., 2010) (arbitration panel's dismissal of claims based on, *inter alia*, failure to disclose revenue sharing payments was subject to doctrine of res judicata); *California v. Edward D. Jones & Co.,* 65 Cal.Rptr.3d 130 (Cal.App.4th 2007) (state claim regarding revenue sharing disclosure); *Capital Research and Mmgt. Co. v. Brown*, 53 Cal.Rptr.3d 770 (Cal. App.4th 2007) (same); *see generally* Kelly Wiese, *Settlement approved in A.G. Edwards Case*, Missouri Lawyers Media, 2010 WLNR 12936709 (June 20, 2010) (describing settlement of state law claims based on failure to disclose revenue sharing); Will Deener, *Suit Says Edward Jones Withheld Information: Law Firm Predicts Number of Complaints Against Broker Will Grow*, Dallas Morning News at 4D, 2005 WLNR 24667030 (July 8, 2005) (describing dozens of revenue sharing disclosure cases filed in arbitration by a single firm); *The Fiduciary Study: A Triumph of Substance Over Form? supra* at 21 - 22.

[16] *See Order Approving Proposed Rule Change*, File No. SR-FINRA-2010-039, Exchange Act Rel. No. 63325, 75 F.R. 71479 (Nov. 23, 2010) (SEC release approving FINRA Rule 2111, effective July 9, 2012); *S*eth Lipner, *The New FINRA Suitability Rules*, 1969 PLI/CORP 173, 192 (Aug. 2, 2012)(FINRA's

allowed undisclosed conflicts in Individual Retirement Accounts, thereby providing greater pressure for the DOL, which is responsible for protecting IRA investors, to step into the void. The absence of a rule-based fiduciary duty has created greater uncertainty by effectively assigning more responsibility for defining fiduciary standards to the dark reaches of FINRA arbitration, where fiduciary breaches are the most common claim brought by investors,[17] but where no guidance about its contours is provided because arbitrators do not issue written explanations of their decisions. Rulemaking paralysis will cause the stresses created by gaps and inconsistencies, like water running downhill, to find another means of release.

The Act does not even foreclose SEC rulemaking under the very Section 913 authority that it seeks to extinguish. The Act's cost-benefit provisions apply to rules promulgated pursuant to Section 15(k)(1), which authorizes imposing conduct standards on broker-dealers pursuant to Advisers Act Section 211. The Act has no effect on the SEC's authority under Section 15(k)(2) to require disclosure specific to the sale of proprietary products, or under Section 15(l)(1) to impose disclosure requirements regarding broker-dealer relationships with customers, or, most pointedly, under Section 15(l)(2) to "promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes" for broker-dealers. These three provisions cover a wide swath of territory that would otherwise be covered by a fiduciary duty, but the rulemaking they permit is far

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new suitability rule does not impose a fiduciary duty but "brings FINRA closer to imposing such a standard on brokers"); Duane Thompson, *FINRA's Quasi-Fiduciary Rule*, fi360 BLOG, July 11, 2012 *available at* http://blog.fi360.com/fi360_blog/2012/07/finras-quasi-fiduciary-rule.html; Christina N. Davilas, David C. Boch, W. Hardy Callcott and John R. Snyder, *FINRA Issues Additional Guidance on its Soon to be Implemented New Suitability Rule* (May 31, 2012) (FINRA "Guidance Announces a new, "Best interests of the Client Standard" that "may be viewed as akin to a fiduciary duty.").

[17] Breach of fiduciary duty was the most frequently asserted arbitration claim from 2008 through mid-2012. For example, of the 4,729 arbitration claims filed in 2011, 2,589 (55%) included breach of fiduciary duty claims. *See* FINRA Dispute Resolution Statistics (July 2012) *available at* http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/. *See, e.g.*, *In the Matter of Billings v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, FINRA Arbitration No. 11-01948 (Oct. 12, 2012) (finding respondent violated fiduciary duty to claimants and awarding monetary relief) *available at* http://finraawardsonline.finra.org/viewDocument.aspx?DocNb=59344.

more invasive and constraining than a best interest standard. Ironically, the cost-benefit burdens that the Act would place on a generalized fiduciary duty may push regulators to prohibit outright practices that would have been palatable under a fiduciary rule. In addition, imposing cost-benefit requirements on a one, discrete grant of rulemaking authority under Section 913 implies a Congressional intent to impose *lower* cost-benefit standards on other grants of authority in the same Section.

The point here is not to show how better drafting could help the Act accomplish its purpose, but rather to illustrate how targeted cost-benefit requirements are particularly ill-suited as indirect mechanisms for repealing or restricting agency rulemaking authority. Even if the Act were revised to cover the three grants of Section 913 authority described above, FINRA would still retain expansive authority to adopt the functional equivalent of a fiduciary duty for its members that would not be subject to the Act's prescriptions (it has, in effect, already begun this process). The Act could be amended to address this end-run, but that would have no effect on SEC enforcement actions. Congress could restrict the SEC's ability to bring fiduciary cases clothed as fraud claims, although it is not entirely clear how, but this would have no affect on public and private enforcement actions under state securities laws. The Act is not just bad policy; it reflects a fatally flawed strategy that is likely to have adverse consequences for all affected parties.

II. Coordination with Federal Agencies

The Act's coordination requirement in Section 15(k)(5) is yet another example of overly intrusive Congressional oversight and appears to reflect a general misunderstanding regarding rulemaking under the securities laws and the Employee Retirement Income Security Act of 1974 ("ERISA"). The Act requires that the Commission take steps to "coordinate retail customer standards of conduct" to minimize conflicts among rules promulgated by other federal agencies. This requirement is presumably intended primarily to ensure that the SEC rulemaking does not conflict with the DOL's ongoing fiduciary rulemaking.

To the extent that "conflicts" refers to situations in which that complying with one set of rules will render a firm out of compliance with another set of rules, there is no reason to believe that the DOL and SEC rules will be in conflict. There was nothing in the DOL's original fiduciary proposal, since withdrawn, or in any statements by the SEC or its staff regarding the SEC's fiduciary rulemaking that would create such a true conflict. In the past, the agencies have routinely ensured that such conflicts are not created, and I am aware of no current conflict between their rules. The most recent *potential* conflict between a DOL rule and the rule of another agency (the CFTC) was resolved before the DOL rule became final. While the DOL's initial fiduciary proposal had its shortcomings, no one has identified anything in the proposal that would have created such a true "conflict."

The concern animating the coordination provision appears not to be a "conflict" in the true sense of the term, but rather the possibility that the DOL may impose more stringent standards, for example, on broker-dealers who advise IRAs than are imposed under SEC rules. This is not a conflict, but an appropriate and necessary policy. In ERISA, Congress *required* that IRAs and other retirement vehicles be subject to more stringent standards than other investments. And it is widely accepted that retirement investments *should* be subject to more stringent standards.

Securities law and ERISA are different regulatory schemes because they should be different. The public interest in employee benefit plans is far greater than for securities investments in general. Investment regulation takes on greater importance in the context of retirement benefits, where losses resulting from misconduct have greater adverse individual and societal consequences than losses associated with securities investments generally. The DOL's application of ERISA's fiduciary duty therefore should not be expected to descend to the level of securities regulation, just as the SEC's application of the fiduciary duty under the securities laws should not be expected to rise to the level of ERISA's requirements.

A possible interpretation of the coordination provision is that it reflects a desire to require the DOL to defer to the SEC's fiduciary rulemaking.[18] For a number of reasons, this effort is ill-advised. Granted, the DOL's initial proposal had fatal flaws, about which I have previously written and testified.[19] The primary flaw was that the proposal failed to extend to new ERISA fiduciaries the same kinds of prohibited transaction exemptions that are relied upon by current ERISA fiduciaries. But the DOL has done all that one could reasonably ask in the wake of its initial foray. It has withdrawn the proposal. It is conducting an exhaustive cost-benefit analysis. And Phylis Borzi, the Assistant Secretary of Labor for the Employee Benefits Security Administration, has repeatedly stated that the re-proposal will include prohibited transaction exemptions that are designed to accommodate existing industry practices.[20] The DOL is likely to issue a proposal in a matter of months. Congress should at least determine what the DOL actually proposes before attempting to use mandatory "conflicts" coordination to address problems that it speculates the proposal may create.

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[18] Some industry lobbyists appear to have incorrectly interpreted the Act this way, possibly as a reflection of its supporters' expectations. *See*, *e.g.*, Mark Schoeff, *House Bill Seen Slowing DOL's Fiduciary Push*, Investment News (May 15, 2013) *available at* http://www.investmentnews.com/article/20130515/FREE/130519952#.

[19] *See*, *e.g.*, Mercer Bullard, DOL's Fiduciary Proposal Misses the Mark, Morningstar.com (June 13, 2011) *available at* http://news.morningstar.com/articlenet/article.aspx?id=384065.

[20] *See* Dianna Britton, *Borzi Hints at Exemptions to DOL Fiduciary Rule*, WealthManagement.com (Apr. 29, 2013) (reporting Borzi comments at conference: "We have to be able to make a finding that allowing certain kinds of transactions and forms of compensation that would otherwise be prohibited because they have the potential for being conflicted for being self-dealing, we have to be able to make a finding that they're in the best interest of participants and beneficiaries.
We think that there are types of compensation that would otherwise be prohibited under a flat prohibition that we will be able to make that finding for.") *available at* http://wealthmanagement.com/imca-2013-annual-conference/borzi-hints-exemptions-dol-fiduciary-rule.

III. Making Investors Pay for Regulatory Confusion

Section 15(k)(4) of the Act requires that the Commission make "formal findings" that a fiduciary rule would "reduce the confusion of a retail customer" about "standards of conduct" that apply to financial professionals. In other words, if the Commission decides that a fiduciary duty would be in the best interests of investors, it must determine that investors have improved their understanding of the legal duties of financial professionals before it can adopt the rule. Thus, the provision effectively requires that Americans become smarter about the legal duties of financial professionals before they can receive the benefit of a fiduciary duty.

The problem of customer confusion is not a problem with the customer; it is a problem with regulation. Customers reasonably expect one standard, but they get something else. They expect professionals who provide them with specialized, personalized advice to be required to act in their best interest, but they receive only the protection of a suitability standard instead. Their best interest expectation is deeply embedded in hundreds of years of common law precedent that holds professionals to higher standards of care and loyalty. Yet this standard is contradicted by the reality that broker-dealers provide professional, personalized investment advice without being held to the almost universal standard that applies to similar professionals, including investment advisers, in commercial contexts.

Regardless of whether one agrees that broker-dealers should be subject to a fiduciary duty, the view that the *investors* are the problem that needs to be solved is extraordinary. It adopts a "blame the victim" approach where fraud is the fault of the investor who loses his life savings investing in products recommended by a conflicted broker because the *investor* should have understood that the broker was not required to act in his best interests. The Act's customer confusion provision does nothing more than hold Americans hostage, denying them the right to efficient legal standards until they prove to regulators that they acquire the legal sophistication to understand them. The solution to investor confusion is not to

require investors to become smarter about regulations, but to make smarter regulations.

IV. Rent-Seeking "Harmonization"

Section 15(k)(6) of the Act imposes a *de facto* requirement that, if the SEC imposes a fiduciary duty on broker-dealers, it must impose a host of additional, unrelated regulations on investment advisers. The provision expressly states that "[t]he Commission shall not propose rules under paragraph (1) for brokers or dealers unless the Commission also proposes rules under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) in the same rulemaking." There is no necessary connection between fiduciary rulemaking and rulemaking for advisers. The provision appears to be nothing more than rent seeking by an industry that wishes to regulate their clients' competitors into submission.

A comparison of this provision and the rest of the Act gives credence to this view. On the one hand, the Act seeks to *restrain* the SEC from adopting rules applied to broker-dealers. On the other hand, it expressly *requires* rulemaking for investment advisers. On the one hand, the Act imposes a host of cost-benefit burdens on rulemaking applicable to broker-dealers. On the other hand, it imposes no cost-benefit burdens on rulemaking applicable to investment advisers. The adoption of a fiduciary duty for broker-dealers automatically triggers rulemaking for investment advisers. Rulemaking for investment advisers does not trigger the adoption of fiduciary duty for broker-dealers. It does not seem to matter what rules are adopted or why, as long as they purport to address "any harm" to investors resulting from differences between investment adviser and broker-dealers regulation. Section 15(k)(6) creates the impression that the Act's purpose is simply to promote the interests of one industry over another without any regard for efficient regulation.

This is not to say that rulemaking to address other inconsistencies between broker-dealer and investment adviser regulation is unwarranted. The SEC should identify and resolve such inconsistencies in the same way that the inconsistent application of the fiduciary duty should be resolved – based on the principle of *functional* regulation. When broker-dealers and advisers provide the same services, they should be subject to the same rules. A fiduciary duty should be applied to financial professionals when they provide personalized retail investment advice, regardless of whether they are broker-dealers or investment advisers. When they are not subject to the same rules, the SEC should consider whether the rules that apply to one should be: (1) extended to the other or (2) eliminated altogether. In contrast, Section 15(k)(6) suggests that the only option is to subject investment advisers to broker-dealer rules even if the rules should apply to no one. This illustrates precisely the kind of blind commitment to an ever-expanding regulatory web that is the antithesis of smart regulation.

The SEC should consider whether broker-dealer rules that are inappropriate for investment advisers may be inappropriate for broker-dealers as well. Similarly, it should consider, when a particular standard for investment advisory services is not appropriate for broker-dealers, whether it may also be inappropriate for investment advisers. The Commission has previously determined that principal trades between broker-dealers and their advisory clients that do not comply with Section 206(3) of the Investment Advisers Act may, in some circumstances, be appropriate. Such transactions may also be appropriate between investment advisers and their clients on similar terms. If the SEC's blanket ban on advisers' testimonials is considered excessive for advisory services provided by broker-dealers, then the SEC should reconsider the ban for investment advisers. The same holds for other rules adopted under Section 206(4). However, the Act's bias for automatically extending broker-dealer rules to investment advisers applies precisely the reflexive rulemaking approach that leads to excessive regulation in the first place.