Testimony of Arthur B. Laby

Professor of Law
Rutgers University School of Law

before the

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on

Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice and Related Proposed Prohibited Transaction Exemptions

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Thank you for the opportunity to present my remarks. My name is Arthur Laby. I am a Professor of Law at Rutgers University and formerly Assistant General Counsel at the Securities and Exchange Commission. I am also a Director of the Certified Financial Planner Board of Standards, but these views are my own, and not necessarily those of the CFP Board. My research focuses on the fiduciary relationship and on the duties and obligations of financial services providers.

I would like to use my time today to discuss what it means to be a fiduciary, to give a few concrete examples of why imposing a fiduciary duty on retirement advisers would be meaningful, and to address the argument that the DOL should defer to other regulatory agencies.

I. The fiduciary obligation

Under the rule, if a person gives advice to a retirement client, that person must do so under a fiduciary standard of conduct. What does this mean? A person is a fiduciary if he or she has been given rights or powers to be exercised for the benefit of another. The most common example of a fiduciary is a trustee, who manages trust assets for beneficiaries. But many advisers are also fiduciaries, such as lawyers, doctors, and some – but not all – investment professionals.

In certain respects, requiring retirement advisers to be fiduciaries should not be controversial. Giving advice, unlike selling a product, is an inherently fiduciary activity. To give advice necessarily means to impart information in another's best interest. Think of other types of advisers: lawyers, doctors, even high school or college counselors who advise on a course of study. They must do so objectively based on the recipient's interest, not based on self-interest or some other motive.

Once a person is a fiduciary, he or she must act in the client's best interest and in accordance with two primary duties – the duty of loyalty and the duty of care. Let's take a minute to understand what these entail.

A. The duty of loyalty

The duty of loyalty is primarily a negative duty to avoid activity that would jeopardize the fiduciary's loyalty. Don't engage in theft or misappropriation. Don't abuse your position or otherwise take advantage of your client. Avoid or mitigate conflicts of interest, or at a minimum, disclose any conflict to your client.

B. The duty of care

The duty of care has a different emphasis. The duty of care is primarily positive and it requires the fiduciary to exercise the care and diligence that a prudent person in similar circumstances would exercise. Think about it: most people engage a fiduciary because they cannot, or do not want, to handle some aspect of their affairs on their own. What the client wants most is for the fiduciary to be diligent and work hard to promote the client's best interest. This requirement is captured by the duty of care.

II. The fiduciary obligation as applied to financial services

Perhaps the best way to understand the fiduciary obligation is to look at examples of how imposing a fiduciary duty on a retirement adviser would matter to investors, and I will turn to some examples now.

Under the law today, broker-dealer representatives who advise retirement clients, are not always held to a fiduciary standard, although many present themselves as advisers and use titles such as "financial adviser" or "financial planner." Instead, brokers are held to a duty of "suitability." They must ensure that investment recommendations are suitable to a client's financial situation. As important as suitability is to investors, brokers in most cases are not required to act in a client's best interest.

Why is this important? Take the example of a broker-dealer representative advising an investor on which mutual fund to purchase. The broker is permitted to receive payments, sometimes called revenue sharing, from mutual fund companies in the form of 10, 20, or 30 basis points when the broker markets and sells the fund. Needless to say, when a broker is paid to market and sell a particular fund, the broker may be predisposed to favor that fund over others.

Now it is possible that this fund is suitable for the investor – it offers the appropriate level of risk for the investor at this time. The fund, however, may not be in the investor's best interest perhaps because it is a higher cost fund than alternatives, or because performance has been lagging compared to peers. Absent the rules we are discussing today, the broker can market and sell this fund to our investor because it is considered suitable. Under a fiduciary standard, the broker must recommend the fund in the investor's best interest, even if that means a fund resulting in lower payments to the broker.

Another example of how a fiduciary duty matters is the way investments are allocated. Imagine a broker who has a limited quantity of a valuable investment. The broker faces a conflict among its clients when dispensing this valuable asset. (This might happen, for example, in the case of an initial public offering.) An individual who is not a fiduciary could allocate the asset to favored clients, while other clients would never know what they missed. (The suitability standard does not impose a duty to manage conflicts.) A fiduciary obligation, however, would require the broker to manage and disclose the conflict and to arrive at a fair process for the allocation decision.

III. Response to critics

I would like to spend my remaining time discussing the view that the Department should defer to other regulators, such as the SEC and FINRA. Some argue that these regulators have securities expertise and developing a best interest standard should be left to them, or that Dodd-Frank gave the SEC authority to address a fiduciary standard and a DOL rule would contradict this Congressional intent.

I am not convinced by the argument that the Department should delay. First, the SEC and the DOL administer different statutes with different philosophies, designed for different purposes. Congress treated retirement assets specially by giving them preferential tax treatment and by protecting them through a fiduciary standard under ERISA. Moreover, ERISA prohibits certain transactions whereas the SEC often regulates through disclosure. Thus, it is not logical to ask the DOL to wait for the SEC, when the philosophical approaches diverge.

Second, as a practical matter, the SEC is not required to adopt a fiduciary rule and it might never do so. In my view, the argument to delay, in some cases, is based on a hope that the SEC will not act, or will adopt a rule that will weaken the applicable fiduciary standard. In any case, waiting for an eventual SEC rule seems pointless. It would be one thing if the SEC were under a deadline, but an SEC rule is discretionary. Also, it seems counterintuitive that the SEC's delay should cause the DOL to delay as well. If anything, the SEC's inaction makes the DOL's initiative more pressing.

Third, if the concern is conflicting regulation, there is little chance of that. The DOL has consulted with members of the SEC and its staff to guard against conflicts. Rules issued by the two regulators may not be identical, but the financial services industry is used to dealing with multiple regulators who regulate the same activity. In fact, advisers to ERISA plans are already subject to both ERISA and the Advisers Act. The key is to avoid genuine conflicts, and the agencies are working to that end.

Finally, action by the Department now could have salutary effects on an SEC rule down the road. Despite the philosophical differences underlying the statutes, there is great potential for the SEC to take advantage of what the Department is doing. The best interest contract exemption, for example, establishes a framework for application of a fiduciary duty in the context of different compensation structures, which are also permitted by section 913 of Dodd-Frank. If the SEC works to establish a uniform fiduciary standard, this framework, and other aspects of the proposed rule, could help inform the SEC's approach.

That concludes my remarks. Thank you again for the opportunity.