

# THE COMMITTEE FOR THE FIDUCIARY STANDARD

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April 12, 2011

By email to [e-ORI@dol.gov](mailto:e-ORI@dol.gov)

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Definition of Fiduciary Proposed Rule, Room N – 5655  
United States Department of Labor  
200 Constitution Avenue, N. W.  
Washington D.C. 20210

## RE: Comments on Definition of Fiduciary Proposed Rule

Ladies and Gentlemen:

This letter is submitted by the Committee for the Fiduciary Standard \* to follow our March 18 meeting with EBSA staff and officials. In this letter we set out views regarding the fiduciary standard, generally, and then address several of the questions that either EBSA staff has raised, or have been raised by commenters.

### **Summary**

The fiduciary backdrop against which ERISA was enacted in 1975 and the record and independent research on which the proposed rule seeks to modernize ERISA today is pertinent. Fiduciary status exists to create an environment where an investor may rely on and have confidence in the expertise of an advisor to do only what's best for the investor. The relationship of trust and reliance is based on the advisor adopting the ends of the investor as his / her own.\*\* Recent research depicts investors' greatly disadvantaged position against investment professionals; suggests disclosures generally fail to overcome this disadvantage; and underscores the central importance of firmly holding advisors or brokers accountable for their recommendations and advice. This research reinforces the rationale for fiduciary status, consistent with the 1963 Supreme Court opinion in SEC v. Capital Gains Research Bureau that recognized fiduciary status in the Advisers Act.

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\*The Committee for the Fiduciary Standard formed in 2009 to advocate for the fiduciary standard under the Advisers Act of 1940 and as represented in the Committee's five core principles. There are over 800 investment professionals who are members of the Committee. Additional information on The Committee for the Fiduciary Standard and its activities can be found at [www.thefiduciarystandard.org](http://www.thefiduciarystandard.org).

\*\* For a full discussion of this view, see, "Arthur B. Laby, "The Fiduciary Obligation as the Adoption of Ends," [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1124722](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1124722)

## 1. Introduction

Fiduciary duties have served vital legal and social objectives for centuries, with one party relying on and trusting the expertise and of another party, who holds property or manages assets. Fiduciary status exists to mitigate the information asymmetry between providers of socially important services that require a high level of expertise, such as law and medicine, and individual consumers of these services (a)

Judicial decisions have noted the existence of a fiduciary standard of conduct. In 1963, the investment adviser's fiduciary status was explicitly confirmed and the special relationship between an investment adviser and its client was recognized by the U. S. Supreme Court in *SEC V Capital Gains Research Bureau* (b).

This recognition resulted, in large part, because of the legislative history of the Investment Advisers Act. The U. S. Supreme Court noted that because of "what happened in this country in the 1920s and 1930s" it is essential that "the highest ethical standards prevail in every facet of the securities industry." Also quoting extensively from the SEC's own report, which addressed advisory services, the Court explained:

*"The report reflects the attitude – shared by investment advisers and the Commission – that investment advisers could not "completely perform their basic function – furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments – unless all conflicts of interest between the investment counsel and the client were removed. "* (c)

The scale of information asymmetry between a retail client and investment professional guides the nature of the fiduciary duties. The retail client can not generally be presumed able to effectively judge the facts and circumstances regarding markets, risks, and products, and then make a decision that is truly "informed." The client cannot be expected to effectively second guess an advisor or broker any more than a patient can be presumed able to effectively question his or her physician.

Consequently, to preserve the fiduciary standard as meaningful investor protection, it is imperative to ensure that the fiduciary advisor is held accountable for his investment recommendations. The advisor must not be legally permitted to circumvent or otherwise shift this responsibility, the fiduciary's responsibility, to the shoulders of the client and, therefore, transform a fiduciary relationship back to an arms length or commercial relationship. In light of this imperative, the question becomes whether disclosures and client affirmation or consent, by themselves, can be considered investor protection tools that uphold the requirements of ERISA.

## **2. The Financial Crisis, Former SEC Chairman, Arthur Levitt, Jr., and Investor Trust**

Former SEC Chairman Arthur Levitt, Jr. testified before the Senate Banking Committee only 26 months ago, in October 2008, (d) about the financial crisis. The former Chairman was blunt and clear. He said “the unthinkable has happened” and called on Congress and the SEC to be “daring.” “The key problem plaguing our markets is a total breakdown in trust – in investor confidence,” Levitt said. “Investors of all sizes and types have little faith in the information they have been given.”

Blaming a lack of transparency, enforcement and resources as major causes of the crisis, Levitt closed his comments stressing that enforcement, with its core task to “keep a market functioning,” is vital. He noted, “Enforcement is so important because ... its holds people accountable.... (and by doing this) the SEC builds the investors’ confidence that someone is looking out for them, which, in turn builds market trust.

“Restoring trust in our markets will require rejuvenating the SEC,” Levitt emphasized. “It is the only agency with the history, experience and specific mission to be the investor’s advocate. Losing that legacy would be devastating to our ability to regulate the markets and restore investor confidence.”

## **3. The Fiduciary Relationship is defined by *Trust***

The fiduciary relationship is based on trust and confidence and premised on the fiduciary discharging duties of care, utmost good faith and loyalty, and remaining solely responsible for carrying out these duties. Uniquely, in contrast to other service providers and product vendors, fiduciaries possess significant specialized expertise that investors can not efficiently acquire. This is the basis of the “knowledge gap” between the fiduciary and the investor.

Investors, by virtue of these circumstances – the very circumstances which explain why fiduciary duties exist – are reliant on the fiduciary’s expertise. This reliance both requires and nurtures the relationship of trust and confidence. This trust and confidence allows investors to accept an advisor or broker’s advice and accept the risk of allowing the advisor or broker to manage their assets. In so doing, investors, by definition, must believe their advisor or broker is trustworthy. This is clear.

It should be equally clear, then, why these investors should not be expected to heed disclosure warnings. In fact, heeding disclosure warnings might be considered rash or illogical. Heeding disclosure warnings would mean the investor has switched from trusting his/her advisor and (usually by) signing a contract and handing over assets to the advisor, to distrusting his/her advisor.

#### **4. The role and effectiveness of disclosures.**

Disclosure “makes up the core of federal securities laws,” Professor Troy Paredes wrote <sup>(e)</sup> in 2003. Professor Paredes pointed out that “(t)wo things are needed for federal securities laws to be effective” – information has to be disclosed and the consumers of the disclosure “need to use the disclosed information effectively.”

He then observed how “federal securities laws generally assume that investors and other capital market participants are perfectly rational, from which it follows that more disclosure is always better than less. However, investors are not perfectly rational.” Furthermore, Paredes wrote, “To the extent that investors, analysts, and other market participants are subject to information overload, the model of mandatory disclosure that says that more is better than less is incomplete and may be counter productive.”

Paredes concludes by stating that the tone and conclusions from his article are “necessarily tentative” and calls for more research. He also notes, “Ultimately we need to understand what investors, analysts, and others do with the information in order to craft a disclosure regime that better satisfies the goals of federal securities laws.”

Key Point. Though not stipulated either way, the article’s comments mainly refer to commercial, as opposed to fiduciary relationships. The “users of information” Paredes refers to – investors (institutional and retail) securities, analysts, brokers and money managers – are often outside a fiduciary relationship. While the importance of disclosure in federal securities law generally is clear, its direct relevance to the role of disclosure in delivering advice to retail clients within a fiduciary relationship is not as clear.

#### **5. Research suggests that investors do not heed disclosure warnings regarding conflicts of interest and they generally do not “discount” the “conflicted” advice, according to Professor Daylian Cain.**

Research by Yale professor Daylian Cain <sup>(f)</sup> demonstrates how difficult it is for consumers to discount conflicted advice. He notes, “Especially difficult in the presence of ‘anchoring’ bias ... this bias persists even if the anchors are being disclosed as being randomly generated. If people have difficulty ignoring advice they know to be random, it seems likely they will have difficulty discounting advice that is merely disclosed as coming from a source that ‘may or may not have a conflict of interest.’”

**6. Research of investor understanding of investment services and costs suggest many investors are uninformed about the services and their costs; they appear far more than “confused” about services, providers and costs.**

Independent research of investors’ understanding of investing, investment services, service providers and investing costs have widely been characterized to suggest that investors are “confused.” However, a closer look at the research suggests a different phenomenon may be at play. Researchers Alan Palmiter and Ahmed Taha, who reviewed the academic literature on mutual fund investors, lament “Fund investors are unaware of the basics of their funds, pay insufficient attention to fund costs, and chase past performance despite little evidence that high past returns predict future returns.”

AARP. The 2007 AARP report, “401(k) Participant’s Awareness and Understanding of Fees” underscores 401 (k) participants’ lack of awareness of plan fees. Key findings: 83% of participants admit “they do not know how much they pay for fees and expenses associated with their own plan, while 65% reported they pay no fees,... (and) 17% stated they do pay fees.” (g)

RAND. The SEC’s 2008 Rand Report, “Investor and Industry Perspectives on Investment Advisers and Broker Dealers,” is widely cited for revealing that investors are unaware of the basic different legal requirements of brokers and registered investment advisers. (h)

“Overall, we found that many survey respondents and focus group participants do not understand key distinctions between investment advisers and broker-dealers – their duties, the titles they use, the firms for which work, or the services they offer.” Rand also reports that investors are generally satisfied with the services they receive, and “this satisfaction was often reported to arise from the personal attention the investor receives.” Regarding investment expenses, “Survey respondents also indicate confusion about fees.”

The Rand report found that 25% of the survey respondents who reported using a financial service provider also report that they paid “\$0” for advisory or brokerage services.

Investnet. The more recent Investnet Fiduciary Standards Study serves to reinforce concerns about investors’ understanding of advisors and brokers. (i) The report characterizes investors as being “foggy” about brokers’ and advisors’ roles and obligations. Of particular note regarding investors’ knowledge of investment expenses and broker or advisor compensation, only 15% of investors state they can “very well” “assess how your advisor gets paid.” (39% state “well” and the 53% state “not too well,” “not well at all” or “don’t know”.)

That only 15% of investors indicate they understand how (and perhaps by implication, what) their broker or advisor is paid suggests there is far more than mere “confusion” involved; it suggests a level of “disengagement” (j) from the services and service provider. As a point of comparison, the question might be asked whether there is any other profession or group of service providers where 85% of their clients or customers acknowledge that they do not know, “very well,” how much they pay for the services rendered.

*Key Point.* These research studies offer insight into the nature of investor “misunderstanding,” and the consequent level of investor risk. The level of the general lack of awareness of the fees and expenses investors pay for their brokerage and advisory services and the prevalence of the belief that these services are “free” suggests a picture that should, at minimum, raise red flags to the profession and regulators alike.

**7. Investor’s substantial misunderstandings of basic aspects of the *business relationship* with their service provider – suggesting a level of disengagement – is separate and apart from investor’s misunderstandings of the markets or investing principles and practices.**

Concern about disclosure ineffectiveness and the knowledge gap is not new. As Paredes notes, William O. Douglas raised this concern in 1934, stating that “those needing investment advice will receive small comfort” from the information provided in the registration statement. (k) More recently, the Tully Report (l) recognized the limitations of most investors, saying it is a “rare client who truly understands the risks and market behaviors of his or her investments.”

The “knowledge gap” between broker or advisor and investor typically refers to markets, investing strategies, practices and the industry jargon used to describe them. The Tully Report is the classic expression of this “gap.” However, the evidence suggesting investors’ substantial misunderstandings of, or disengagement from, the most basic aspect of the business relationship (the costs of the service) is additional to and separate from investors being uninformed about investing. It is arguable this business relationship “knowledge gap” presents even greater client risk than the knowledge gap of investing, generally.

**8. The nature of fiduciary duties correlates with the level of client risk.**

The nature of a fiduciary’s duty in law varies depending on the level of risk of the client. This risk level is generally determined by assessing the scope of the authority granted the fiduciary and the capacity of the investor to check, monitor or control the fiduciary.

The significant investor limitations (noted above) and the associated investor risks suggest the nature of the fiduciary relationship between an advisor or broker and investor should more closely parallel the relationship of the trustee and trust beneficiary as opposed to the principal agent relationship. They should be regulated as such. The key rationale for the trustee and trust beneficiary model centers on these limitations and the “knowledge gap” that is not the case in the principal-agent relationship. <sup>(m)</sup>

The fiduciary duties required in the advisor-retail client relationship described here are the more stringent duties. The burden on the fiduciary to overcome the presumption against proceeding with a transaction when a material conflict of interest is present is significant.

As opposed to the fair dealing or suitability standard associated with transaction facilitation, the fiduciary standard requires the fiduciary to ensure the client understands the potentially detrimental implications of the conflict on the client, to obtain fully informed client consent and, critically, to also be able to demonstrate that, despite the conflict, the transaction remains fair and reasonable and consistent with the client’s best interest.

**9. Concerns expressed to EBSA about the proposed rule should be viewed in the context of the essential purpose of fiduciary status and the clear limitations of most investors, as revealed by independent research.**

Particular concerns expressed by commenters should be carefully examined. Does the concern question the core rationale that fiduciary status exists? Does it consider or incorporate the limitations of most investors – or does it assume these limitations do not exist? Or, conversely does it identify a circumstance that reasonably could create an unintended consequence that would undermine a fiduciary duty?

**10. Concerns of Increased Costs. Increased costs concerns should only be considered to the extent credible research or data is provided to support these concerns. Credible analysis and data should also negate the presumption that investment expenses may actually decrease under the fiduciary standard because excessive investment expenses are considered imprudent and a potential fiduciary breach under the fiduciary standard.**

SIFMA expresses repeated concerns that the proposed rule will increase costs (see February 9, 2011 letter, March 1 testimony of Ken Bentsen, page 85). Among other things, SIFMA points to a presentation it commissioned by Oliver Wyman to evaluate the impact of harmonizing the fiduciary and suitability standards. While purporting to show that harmonization will increase costs, because the underlying study data has not yet been made available to EBSA, it is not possible to independently assess the study. <sup>(n)</sup>

Further, it appears that one of the challenges SEC staff has faced in analyzing certain comments expressing cost concerns is the paucity of quantitative data provided to support differing views. For example, a review of the discussion provided on the topic of proceeding with a uniform standard, and the section addressing “Costs to Retail Investors, Including Loss of Investor Choice” in the SEC staff’s study is illustrative. <sup>(o)</sup>

The SEC staff’s study recounts comment letters suggesting a new uniform standard “might significantly increase costs for broker-dealers, which would then be passed on to retail investors, ..... some commenters indicated that litigation would increase.... [and this would] increase the cost of insurance for the firm,” however, the study notes, “*None of the commenters provided any quantification of such anticipated costs*” (emphasis added.) Further the study notes, “Commenters speculated” increased costs would cause many broker-dealers to stop offering certain products; while other commenters countered “the costs and impact on investor choice would be de minimis.”

Further, the staff’s study, as it deals with “potential costs” to retail investors of a harmonized standard, noted, “Commenters generally did not address whether or how additional harmonization of the broker-dealer and investment adviser regulatory regimes would impact investor choice.” The study summarizes, “Generally, commenters did not quantify particular costs or even give a range of costs they would incur for various potential outcomes.” <sup>(p)</sup>

Finally, any credible analysis and discussion of the impact on costs associated with practices and procedures due to the fiduciary standard should also consider the potential cost savings. There is no debate that, with notable exceptions, the suitability standard generally does not require a broker to control investment expenses as does the fiduciary standard. As no representatives of the brokerage industry disputes this fundamental difference, the question must be asked why investment expenses would not be expected to *decrease – and not increase --* under the pressure of market forces that reflect this duty.

**11. Disclosures do not equal the client best interest fiduciary standard. Commenters expressing trust in disclosures as the central pillar of the fiduciary standard actually, and perhaps inadvertently, express their trust in an improved suitability or general commercial standard – not the fiduciary standard.**

Some commenters express their trust and faith in disclosures as the pillar of the fiduciary standard. In the public hearing, Ken Bentsen notes (March 1, page 120):

*“Whether its in the investment or any other part ... of their daily lives, of – and you know, we have operated our markets very much on the basis of a disclosure regime and in agreements between two parties.”*

In the same discussion, Charles Nelson of Great Western Retirement Services states (March 1, page 129):

*“We live in a world that is full of business relation conflicts, and that in our every day life, we’re engaging in a variety of transactions, whether its for a product or a service. And I don’t think this is really all that different, and I actually have faith in the American consumer here and... that with good disclosure on what their fees might be and contractual arrangements around what their services are being provided, that a consumer can make an informed decision.”*

Both commenters, in comparing fiduciary status to a commercial transaction common in “their daily lives” (Bentsen) or “in our every day life” (Nelson) appear to reject out of hand the well established fundamental nature of fiduciary status and the centuries-old rationale for its existence. As such, these comments, generally, appear to simply make the straightforward case for the suitability standard as the standard EBSA should adopt. This conclusion seems consistent in Mr. Bensen’s case, when he notes during the hearing “No ... we don’t find a lot in it (the proposed rule) that we would be supportive of.” (March 1, page 110)

Finally, consistent with this faith in disclosure and the suitability standard, Bentsen also expresses the view that based on “the data” investors choosing the brokerage - commission business model do so, “it would appear...based on price.” (March 1, page 127) No specific underlying data are offered to support this conclusion. The significance of this view is that it seems to be inconsistent with the independent research findings, noted above, where investors were found to be generally very unaware of the costs of their investments.

**12. The sales exemption, if allowed, should only be permitted if there is a clear and unambiguous written “informed understanding” statement from the advice recipient that the seller’s advice is no longer impartial.**

Paragraph ( c ) ( 2 ) ( 1 ) provides that a person will not be considered an ERISA fiduciary if that person can “demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice ... in its capacity of a ... seller of a security.”

This exemption would apply to an investment adviser who is “a fiduciary of the plan under section 3 (21)(A)(i) or (111).

While the Department notes correctly that there is an “inherent expectation of impartial investment advice” on the part of advice recipients when there is a representation of ERISA fiduciary status, it suggests there may not be such an expectation without this representation. Given the general level of investor disengagement noted above, and the more specific limitations and potential harms associated with disclosures as noted by Professor Cain in our March 18 meeting, this language appears to allow for an escape of fiduciary duties without any understanding of the switched capacity by the advice recipient, much less what this switched capacity means. To merely allow a claim that the recipient “reasonably should know” the adviser in his / her capacity of a “seller” is to allow for rampant misuse. Further to not require any demonstration of a written “informed understanding” would be to miss an opportunity to contribute to a major step forward in a small but pivotal arena.

The comments on this proposal are revealing of the misunderstandings of the fundamental difference between a sales standard as opposed to the fiduciary standard. At its heart, this misunderstanding presumes the standards are very similar, and not fundamentally different. This is essentially inaccurate. This is inaccurate because the suitability – sales standard permits reps to put the interest of the rep and firm above the interest of the plan participant or sponsor. The suitability standard does not require reps to be held accountable to control investment expenses, to disclose all material conflicts, to disclose all fees and expenses, to avoid material conflicts, or to manage any unavoidable conflicts in the interest of the investor, get informed consent from the investor, and, if the transaction is completed, to still demonstrate the transaction is in the investor’s best interest.

Based on these material differences it is accurate and important to describe the relationship in terms that correctly reflect this difference. Terms such as “not aligned,” “adverse” “opposed” reflect this difference every bit as much as they reflect the difference between two brokers negotiating the final price between the seller and the buyer of a home. We suspect commenters would not object for a moment to describing opposing brokers in such terms.

Commenter: “Adverse” is not accurate. One commenter (Nelson, March 1, page 80, op. cit.) states the term “adverse” is legally not accurate because “federal and state laws require financial service providers to take into account the needs of their clients.” This reference to the requirement that the recommendation must be suitable is consistent with an “adverse” position. Suitability allows the rep. very wide discretion that essentially means the minimum requirement permitted is that the recommendation can not be unsuitable. This “not unsuitable” minimum requirement allows for the sale of many products that, while perhaps in the best interest of the firm or rep, are not in the best interest of the investor.

Commenter: No zero-sum game. Another commenter <sup>(q)</sup> argues as to why it objects to what it calls having a service provider “branding itself a conflicted advisor” and the language “adverse” and “not undertaking to provide impartial investment advice.” As explained, “In any business built on relationships, sellers and buyer both benefit when the buyer feels as though she has received good value. As a result, sales relationships are not a zero-sum game ... characterizing the seller as adverse is inaccurate. Similarly, if a person is “not undertaking to provide impartial investment advice,” the implication is that he or she is in fact providing conflicted advice.... It would be far more useful for the seller simply to note it is not giving “advice,” but that it is proposing a sale.”

This commenter seems to seek to redefine the essential nature of a sales professional. The best sales professionals are ethical and know their products well; product information is imparted as facts and as advice. Within legal and ethical bounds of the industry, the best sales professionals also seek to increase their sales as they are compensated for doing so.

That “sales” advice is “conflicted” only suggests that the sales professional cannot be objective about products he does not sell. This should be beyond debate, and to suggest otherwise should be considered unserious. Second, the commenter then suggests “sellers and buyers both benefit when the *buyer feels as though she has received good value.*” (Emphasis added.) This is an excellent example as to the material difference between “advice” and “sales,” and why the Department is correct in shining a light on this difference.

While a sales professional seeks (as noted above) to make the customer “feel” good; a fiduciary advisor seeks to recommend what is best. The fiduciary advisor gains no incremental monetary value for rendering his/her best advice; while, in fact, the investor (buyer) may well “feel” very bad after receiving sober advice, advice that is in his / her best interest.

Conclusion. Some parts of the industry seem to believe its' sales professionals who have legal obligations and financial incentives of sales professionals will be "advisors" by simply saying they are "advisors." After many years of calling sales professional "advisors", suggestions now that sales professionals be characterized as sales professionals appears to be unsettling to some.

In the sales exemption, the Department has the opportunity to realign the titles and language describing sales professionals as sales professionals with their functional tasks, legal obligations and financial incentives. The sales exemption provides an excellent opportunity to redraw a sharp line between the role and duties of sales professionals representing their firms, and fiduciary advisors representing plan participants and sponsors. In so doing, we recommend the following:

The independent research (noted above) regarding investor perceptions of investment services suggests many plan participants will not be aware of the shifting capacities, and if they are aware, will not appreciate the relevance of the fiduciary versus sales capacities. For this reason requiring the sales professional to only "demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice ... in its capacity of a ... seller of a security" is plainly insufficient. The plan participant should be required to affirm in writing that he or she understands the shifting capacities and possesses an "informed understanding" of what this means.

**13. Fiduciary status today carries enormous responsibility – far greater, in terms of the nation's investible assets, than the responsibility it carried in 1940 when the Advisers Act was enacted.**

This record of investor limitations and disengagement – a record that has not been questioned by any credible independent authority -- simply underscores the vital mission of fiduciary status today for the 50% of households investing, indirectly or directly, in the market. This fiduciary mission is, arguably, far more vital today than was the fiduciary mission when first established under the Advisers Act of 1940, when only 1% to 2% of the households invested.

For this reason alone, any revisions as to how *fiduciary* is defined and applied under ERISA should be made such that advisors and brokers remain solely accountable to plan sponsors and participants for the quality of their advice.

## 14. Closing Summary

The essence of the fiduciary relationship is trust, founded on confidence and reliance that the advisor or broker only acts in the best interest of the client, and is solely responsible for his decisions and recommendations. In *Capital Gains*, the Supreme Court found the Advisers Act aimed, in the wake of the scandals of the 20s and 30s, to reestablish this standard and this required, according the Court, removing “all conflicts of interest between the investment counsel and the client.”

While the essence of the fiduciary relationship is trust founded on confidence and reliance, two commenters generally critical of the proposed rule compare the fiduciary standard to the standard in business transactions. In so doing they appear to matter-of-factly affirm their support for the commercial suitability standard as the appropriate standard to be adopted by EBSA.

Additionally, separate new research suggests the depth of investor disengagement regarding the costs of investment services is material. Thus when a conflicted relationship exists, the risks to clients are significant and merit the highest fiduciary level of obligations available.

Moreover, even if disclosures were shown to be effective in some instances, (the Committee has seen no party or group offer evidence during this current debate that disclosures are effective), a disclosure regime on its own should still be rejected to address conflicts of interest. Reliance on casual disclosures, alone, is the opposite of reliance on the fiduciary professional’s recommendation, and negates the very purpose of the fiduciary standard.

There are two clear and distinct visions of the meaning and vitality of the fiduciary standard as it addresses conflicts of interest. One vision is offered by both the Court in *Capital Gains* and former SEC Chairman Arthur Levitt. Their views speak to the importance of 1) rigorous enforcement as key to investor trust and confidence, and 2) the vital mandate that conflicts be “removed.” The other vision speaks of “disclosures” and of allowing “retail customers” ... “make informed choices,” and the importance of “customer consent” being attained in a “pragmatic way.” We submit the first view is superior and upholds the same fiduciary principles that have anchored fiduciary law for centuries.

The Committee for the Fiduciary Standard is comprised of leaders in the advisory industry who are prepared to provide any assistance to the Department as it addresses this critical issue.

Sincerely,

*Knut A. Rostad*

Knut A. Rostad  
Chairman

Copies to:

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#### Notes

- a. For a general discussion of the role of the fiduciary from an historic perspective see, Blaine F. Aikin, Kristina A. Fausti, "Fiduciary: A Historically Significant Standard."

For a discussion of the rationale for fiduciary law, see "Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers," Tamar Frankel, \_\_\_\_

- b. 375 U. S. 180.
- c. Id at 184.
- d. Testimony of Arthur Levitt, Jr., Senate Banking Committee; Washington DC 15 October 2008 – Submitted to the Record
- e. Troy Paredes, Associate Professor of law, "Blinded by the Light: Information Overload and its Consequences for Securities Regulation"
- f. For a detailed treatment of this subject, see,

Conflicts of Interest: Problems and Solutions from Law, Medicine and Organizational Settings (with D.A. Moore, and G. Loewenstein, and M. Bazerman, eds.), Cambridge University Press, 2005.

Also, see: "The Dirt on Coming Clean: The Perverse Effects of Disclosing Conflicts of Interest" (with G. Loewenstein and D. A. Moore), *Journal of Legal Studies*, January, 1-25, 2005.

- g. See [http://assets.aarp.org/rgcenter/econ/401k\\_fees.pdf](http://assets.aarp.org/rgcenter/econ/401k_fees.pdf)
- h. See [http://www.sec.gov/news/press/2008/2008-1\\_randiabdreport.pdf](http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf)
- i. See <http://www.thefiduciaryopportunity.com/>
- j. To suggest only that investors are *confused*, in light of the investor views discussed here, is to consider the research data in a very narrow sense, and is to understate what appears to be investors' misunderstandings with their service providers. It is true that investors "confuse IAs from BDs." But this confusion is not the only issue.

A dictionary definition of "confuse" serves to suggest that the investor behavior noted here extends beyond what is typically associated with *confusion*. The definition of confuse includes "perplex," "bewilder," or "to fail to distinguish." As examples, of using *confuse* or *confusion* in a sentence, these definitions offer, for example: "He always confuses the twins." Or, "Try not to confuse the papers on the desk." (See Dictionary.com)

The scale of investor unawareness of fees, expenses and compensation reflects such a fundamental "gap" that it seems far more appropriate to associate this phenomenon as an indicator of *disengagement* more than of *confusion*. Examples of definitions of *disengage* include: "To release or become released from a connection," or, to "detach," "disconnect" or "uncouple." (See Dictionary.com for further examples.)

By only suggesting that investors are *confused*, and by continually applying the label of *investor confusion* to what we observe of investor conduct and views, we may be subtly framing the circumstances far more positively than the evidence actually warrants. In doing so, we may be understating the gravity of investors' misunderstandings of investing and their advisor or broker.

- k. Paredes \ supra note (e) at 14.
- l. See: <http://www.sec.gov/news/studies/bkrcomp.txt>
- m. For a discussion of the varying scope of fiduciary duties, see: Tamar Frankel, *Fiduciary Law*, 71, Calif, L. rev. 795 (May 1993)

Also, Professor Deborah DeMott, Duke Law School, David F. Cavers Professor of Law notes regarding agency law and advisory relationships:

“Agency law is not a good starting point for analyzing advisory relationships because the recipient of the advice ... necessarily relies on the advisor's greater expertise, and lacks the realistic ability to monitor how the adviser formulates its recommendations. This is especially so when the recipient of advice is an individual (non-institutional) client, even more so when the advisor is the client's sole source of advice. Additionally, agency at its heart is about relationships in which an actor represents a principal in interactions with third parties (by acting "on behalf of" the principal), which isn't the same thing as furnishing advice.

Separately, agency law itself requires consent by the principal to conduct that would otherwise breach the agent's fiduciary duties. The agent bears the burden of showing that such consent has been obtained. to be effective, a principal's "consent" must be informed as to facts "that would reasonably affect the principal's judgment," a standard that is not satisfied by blanket consents that lack specificity, such as "consent" to an agent's use for its own purposes or those of third parties of information furnished by the principal to the agent. Agency law differentiates between "general or broad language purporting to release the agent in advance from the agent's fiduciary obligation" and consent by the principal "to specific transactions or to specified types of conduct ...." See Restatement (Third) of Agency sec. 8.06, cmt. b ("a broadly sweeping release of an agent's fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective the release would expose the principal to the risk that the agent will exploit the agent's position in ways not foreseeable by the principal at the time the principal agreed to the release.")

- n. Standard of Care Harmonization: Impact Assessment for SEC, October 2010. The presentation suggested cost impacts of the uniform standard on its member firm customers. Analysis was offered in this presentation from SIFMA members that it is claimed suggests fee-base accounts are more costly to investors than are brokerage accounts. However, due to the lack of access to the underlying data itself, it is not possible to independently analyze the study data and draw conclusions about how it should be interpreted. Also, it should be noted here that both SEC and EBSA staff have requested SIFMA to provide the underlying data such that the presentation could be independently assessed. To date, to our knowledge, the underlying data has not been provided by SIFMA.
- o. SEC Staff Study on Investment Advisers and Broker Dealers, see page 159.
- p. See discussion beginning on page 146.
- q. See Groom Law Group, February 3, 2011 comment letter.