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The Other Securities Regulator: A Case Study in Regulatory Damage

Anita K. Krug

University of Washington School of Law

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The Other Securities Regulator: A Case Study in Regulatory Damage

Anita K. Krug*

Although the Securities and Exchange Commission is the primary securities regulator in the United States, the Department of Labor also engages in securities regulation. It does so by virtue of its authority to administer the Employee Retirement Income Security Act (ERISA), the statute that governs the investment of retirement assets. In 2016, the DOL used its securities regulatory authority to adopt a rule that, for the first time, designates securities brokers who provide investment advice to retirement investors as fiduciaries subject to ERISA's stringent transaction prohibitions. The new rule's objective is salutary, to be sure. However, this Article shows that, by way of its reformation of many advisers' relationships with their retirement-investor customers, the "fiduciary rule" imperils retirement investors in ways that are not immediately evident and that other scholars have not noticed. First, the rule promotes a particular investment strategy—namely, passive investing—for all retirement investors, regardless of their individual needs or objectives. Second, as a thought experiment demonstrates, the rule portends a constriction of most retirement investors' participation in the securities markets and a still-wider gap, in terms of investment opportunities and performance, between these investors and their "sophisticated" counterparts. Despite these difficulties and speculation that the Trump administration would scuttle the rule, moreover, the rule's effects are likely enduring.

Given the damage that the fiduciary rule threatens to inflict on retirement investors, the DOL's adoption of it is an episode of failed rulemaking—one that, as this Article contends, may be traced to doctrinal factors: U.S. securities regulation is based on the notion that regulation should be neutral as among firms' business and financial objectives and should harness, without necessarily abolishing, financial professionals' conflicts of interest. Yet with its fiduciary rule, the DOL has effectively forsaken the principle of neutrality and deployed a scorched earth strategy against conflicts. With a view toward addressing the special concerns that shared regulatory authority creates, the Article delves into the lessons arising from this episode and how policymakers might better promote regulatory objectives and sound policy going forward.

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* © 2017 Anita K. Krug. Interim Toni Rembe Dean and Professor of Law, University of Washington School of Law. The author thanks the participants at the 2016 Investment Funds Roundtable at Boston University for their comments on prior drafts of this Article or the topics it addresses.

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I. INTRODUCTION

Securities regulation is a controversial subject. For example, investor advocates contend that today's U.S. securities regulatory apparatus contains too many exemptions and loopholes and is too lenient in enforcing anti-fraud requirements. Meanwhile, financial firms and their constituents counter that regulatory strictures are already too burdensome and that, in any event, enforcement initiatives are adequate to punish and deter wrongdoers. Despite disagreements on these topics and many others, however, most observers agree that the objectives of securities regulation are to protect investors, foster confidence in the U.S. securities markets, and promote the growth of investment in business enterprises and nonprofits.¹ There is also broad consensus that the regulatory agency charged with advancing these objectives is the Securities and Exchange Commission (SEC).

Yet a second regulator has increasingly made its mark on the U.S. securities realm, fundamentally shaping how the securities markets operate. This other regulator is the Department of Labor (DOL). The DOL engages in securities regulation by virtue of its authority to administer the Employee Retirement Income Security Act (ERISA),² whose purpose is to protect retirement investors—meaning employee benefit plan participants and owners of individual retirement accounts (IRAs)—from harm at the hands of those who have control over these investors' assets or otherwise are in a position

1. See Abraham J.B. Cable, *Mad Money: Rethinking Private Placements*, 71 WASH. & LEE L. REV. 2253, 2263 (2014) ("Commentators generally agree that securities laws . . . should facilitate capital formation and protect investors.").

2. Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1461 (2012).

to benefit themselves to the investors' detriment.³ Moreover, the Department's role as a securities regulator is significant, given that U.S. retirement assets presently total nearly \$25 trillion and account for 36% of U.S. household financial assets.⁴

ERISA furthers its objectives in part through designating as a fiduciary any financial professional who provides investment advice to retirement investors about investment products and portfolio allocation.⁵ By imposing on these advisers a stringent standard of conduct and prohibiting them from entering into certain types of transactions, the statute establishes the general framework for fiduciaries' obligations to retirement investors.⁶ However, it leaves certain specifics to the DOL, including what constitutes the type of advice that causes an adviser to be an ERISA fiduciary,⁷ and gives the Department authority to adopt exemptions from its (that is, ERISA's) prohibited transaction provisions.⁸ Over the years, the DOL has used its power under ERISA to adopt scores of rules and prohibited transaction exemptions.⁹ Until last year, although this output had substantially changed how advisers who were ERISA fiduciaries—primarily only those advisers who were also registered and regulated as investment advisers under the securities laws—provided services to retirement investors, it did not alter these advisers' business models or the general nature of their services.

The DOL's longstanding accommodation of most advisory activities changed in 2016, when the agency adopted a rule that has all but upended the financial advisory industry. The rule—actually, a suite of associated rules—designates as ERISA fiduciaries a large

3. See *History of EBSA and ERISA*, U.S. DEP'T LAB., <https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/history-of-ebsa-and-erisa> (last visited Aug. 28, 2017) (noting that one of ERISA's goals is "to protect the interests of participants . . . in employee benefit plans").

4. See Nick Thornton, *Total Retirement Assets Near \$25 Trillion Mark*, BENEFITSPRO (June 30, 2015), <http://www.benefitspro.com/2015/06/30/total-retirement-assets-near-25-trillion-mark>.

5. See 29 U.S.C. § 1002(21)(A) ("[A] person is a fiduciary with respect to a plan to the extent . . . he renders investment advice for a fee or other compensation . . . with respect to any moneys or other property of such plan . . .").

6. See *id.* §§ 1104, 1106.

7. See *id.* § 1135 (granting the DOL authority to adopt rules "to carry out the provisions" of ERISA, including to "define accounting, technical and trade terms used in such provisions").

8. See *id.* § 1108(a).

9. See Best Interest Contract Exemption, 81 Fed. Reg. 21,002 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2550) (setting forth the DOL's rules pertaining to "fiduciary responsibility" under ERISA).

swath of financial professionals who previously did not qualify as such.¹⁰ These professionals are advisers employed by securities brokerage firms who provide sporadic investment recommendations to their customers, many of whom are retirement investors, but who are primarily securities brokers whose advisory activities are not so extensive as to cause them to be deemed investment advisers under the securities laws.¹¹

Although the objective of the “fiduciary rule”—to give retirement investors stronger fiduciary protections—is salutary, the rule is among the most controversial ever adopted by a federal regulatory agency. After the DOL proposed the rule in April 2015, interested parties submitted thousands of comment letters expressing their strong opposition or support for the proposal,¹² while other observers imparted their views in editorials and blog posts.¹³ This attention intensified upon the rule’s adoption, as numerous financial and insurance firms filed lawsuits claiming, among other things, that the DOL lacked authority to adopt the rule and that Congress had expressly disagreed with many of the rule’s proscriptions.¹⁴ To the extent that, by late 2016, the clatter had begun to wane, Donald

10. See Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, 2550).

11. See Michelle Singletary, *Is Your Adviser Truly Protecting Your Retirement?*, WASH. POST (Sept. 12, 2015), https://www.washingtonpost.com/business/get-there/is-your-adviser-truly-protecting-your-retirement/2015/09/10/9a66a2fe-564d-11e5-8bb1-b488d231bb_a2_story.html (discussing the purpose of the rule).

12. See *Public Comments, Conflict of Interest Proposed Rule*, U.S. DEP’T LAB., <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2> (last visited Aug. 29, 2017); *Public Comments, Conflict of Interest Exemptions—Proposals*, U.S. DEP’T LAB., <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25> (last visited Aug. 29, 2017).

13. See, e.g., Tara Siegel Bernard, *More Protection for a Nest Egg Has Some Brokers Upset*, N.Y. TIMES: YOUR MONEY (Sept. 18, 2015), <https://www.nytimes.com/2015/09/19/your-money/more-protection-for-a-nest-egg-has-some-brokers-upset.html> (quoting opponents and proponents of the then-proposed fiduciary rule); Daisy Maxey, *Battle Continues Over Fiduciary Rule for Retirement Investments*, WALL ST. J.: MKTS. (June 14, 2015, 11:13 PM), <http://www.wsj.com/articles/battle-continues-over-fiduciary-rule-for-retirement-investments-1434054916> (same); Meghan Milloy, *DOL’s Proposed Fiduciary Rule: Not in the Best Interest of Investors*, AM. ACTION F. (Aug. 4, 2015), <https://www.americanactionforum.org/research/dols-proposed-fiduciary-rule-not-in-the-best-interest-of-investors/> (contending that the then-proposed fiduciary rule would harm investors).

14. See, e.g., Complaint, Thrivent Fin. for Lutherans v. Perez, No. 16-cv-03289 (D. Minn. Sept. 29, 2016); Complaint, Mkt. Synergy Grp., Inc. v. U.S. Dep’t of Labor, No. 5-16-cv-04083 (D. Kan. June 8, 2016); Complaint, Nat’l Ass’n for Fixed Annuities v. Perez, No. 1:16-cv-01035 (D.D.C. June 2, 2016); Complaint, Chamber of Commerce of the U.S. v. Perez, No. 16-cv-01476 (N.D. Tex. June 1, 2016) [hereinafter Chamber of Commerce Complaint].

Trump's election as president resurrected it, raising the prospect that his administration would undermine the rule, either by repealing it, refusing to defend it against the pending lawsuits, or foregoing enforcement of it.¹⁵ Yet the lawsuits have generally failed at the summary judgment stage,¹⁶ and it now appears that, despite an executive order directing the DOL to reevaluate the rule¹⁷ and a delay of its compliance date,¹⁸ the new administration will likely not subvert

15. See Warren S. Hersch, *DOL Rule Faces Certain Death Under President-Elect Trump*, THINKADVISOR (Nov. 9, 2016), <http://www.thinkadvisor.com/2016/11/09/dol-rule-faces-certain-death-under-president-elect> (“[T]he DOL’s widely criticized conflict-of-interest regulations will not survive a united wall of opposition from Congress, the courts or the Republican administration of President Donald J. Trump.”).

16. See, e.g., Mark Schoeff Jr., *Dallas Judge Upholds DOL Fiduciary Rule*, INVESTMENTNEWS: FIDUCIARY FOCUS (Feb. 8, 2017, 5:11 PM), <http://www.investmentnews.com/article/20170208/FREE/170209907/dallas-judge-upholds-dol-fiduciary-rule> (reporting that the district court for the Northern District of Texas, in granting summary judgment to the DOL, “shot down each of the major arguments submitted by industry trade groups”); Mark Schoeff Jr., *Kansas Judge Again Upholds DOL Fiduciary Rule*, INVESTMENTNEWS: FIDUCIARY FOCUS (Feb. 17, 2017, 6:46 PM), <http://www.investmentnews.com/article/20170217/FREE/170219896/kansas-judge-again-upholds-dol-fiduciary-rule> (“A Kansas federal judge upheld the Labor Department fiduciary rule on Friday, giving the measure its fourth court victory since November.”); *Trial Court Rejects DOL Fiduciary Rule Challenge*, THOMSON REUTERS: TAX & ACCOUNTING (Dec. 1, 2016), <https://tax.thomsonreuters.com/checkpoint-ebia-newsletter/trial-court-rejects-dol-fiduciary-rule-challenge/> (reporting that two courts had denied litigants’ requests for preliminary injunctions).

17. See President Donald J. Trump, *Fiduciary Duty Rule: Memorandum for the Secretary of Labor*, 82 Fed. Reg. 9675 (Feb. 7, 2017) (directing the DOL to “examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice”).

18. On February 9, 2017, the DOL proposed to the Office of Management and Budget (OMB) that the rule’s compliance date be delayed by 180 days, subject to a comment period. See Sarah N. Lynch, *Exclusive: Labor Department To Delay, Revisit Fiduciary Rule—Sources*, REUTERS (Feb. 9, 2017, 6:08 PM), <http://www.reuters.com/article/us-usa-brokerage-regulation-exclusive/exclusive-labor-department-to-delay-revisit-fiduciary-rule-sources-idUSKBN15P007>; Jacklyn Wille, *Trump and the Fiduciary Rule: The Uncertainty of What’s Ahead*, BLOOMBERG BNA (Feb. 13, 2017), <https://www.bna.com/trump-fiduciary-rule-n57982083674/>. With the OMB’s approval, the DOL ultimately postponed the rule’s original April 10, 2017, compliance date by sixty days, establishing June 9, 2017, as the new compliance date. See *Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128*, 82 Fed. Reg. 16,902 (Apr. 7, 2017) (to be codified at 29 C.F.R. pt. 2510). In addition, the DOL postponed implementation of certain components of the rule from January 1, 2018, to July 1, 2019. Mark Schoeff Jr., *DOL Fiduciary Rule: Agency Says It Will Come Up with New Ways To Comply During Delay Period*, INVESTMENTNEWS: FIDUCIARY FOCUS (Aug. 30, 2017, 2:30 PM), <http://www.investmentnews.com/article/20170830/FREE/170839993/dol-fiduciary-rule-agency-says-it-will-come-up-with-new-ways-to>.

the rule's trajectory.¹⁹ Moreover, even if the judicial process or the administration were to ultimately scuttle the rule, that action would likely not undo the rule's impact.²⁰

The core of that impact is the fact that ERISA deems it a conflict of interest for a fiduciary to be compensated for her services on a per transaction basis and therefore prohibits such compensation.²¹ Yet transaction-based compensation defines how securities brokers do business. After all, brokers receive commissions for executing securities trades.²² In selling securities from their own inventories in their capacities as securities dealers, they receive markups—

19. See Michael Kitces, *DoL Fiduciary Not Yet Delayed By President Trump After All . . .*, NERD'S EYE VIEW (Feb. 4, 2017, 9:30 AM), <https://www.kitces.com/blog/president-trump-executive-order-memorandum-no-fiduciary-rule-delay/> (describing the challenges associated with revising or rescinding the rule or delaying its applicability date and noting that “[a]t a minimum . . . it’s looking increasingly likely that the DoL fiduciary rule will be here to stay in some form”); Wille, *supra* note 18 (citing experts who believe that despite ongoing controversy, the fiduciary rule “may be here to stay”).

20. It is expected that even after a repeal of the rule, securities brokers would maintain the business practices they implemented in order to comply with the rule. See Zeke Faux, *Trump’s Fiduciary Rule Order Seen Unlikely To Stop Fee Shift*, BLOOMBERG (Feb. 3, 2017, 7:20 AM), <https://www.bloomberg.com/news/articles/2017-02-03/trump-s-fiduciary-rule-order-seen-unlikely-to-stop-fee-shift> (reporting that President Trump’s initiatives to repeal the “fiduciary rule” are “unlikely to derail the . . . changes already under way in response” to the rule); Melanie Waddell, *Trump To Direct DoL To Delay Fiduciary Rule: Sources*, THINKADVISOR (Jan. 31, 2017), <http://www.thinkadvisor.com/2017/01/31/trump-to-direct-dol-to-delay-fiduciary-rule-source> (noting that securities brokers have changed their business models and compensation practices in order to comply with the rule and that “with . . . or without” the rule, “commission-based business models are on their way out”); Michael Wursthorn, *New Retirement Rule Is Delayed, but Not Its Impact*, WALL ST. J.: MKTS. (Apr. 8, 2017, 8:00 AM), <https://www.wsj.com/articles/new-retirement-rule-is-delayed-but-not-its-impact-1491652800> (reporting that a repeal of the rule likely will not cause financial firms to revert to pre-rule business practices and that various financial firms intend to “forg[e] ahead” with implementing the fiduciary rule, notwithstanding uncertainty about its fate). In addition, the intense popular discussion about the rule has likely permanently heightened regulatory and customer scrutiny of securities brokers’ conduct. See Jeff Benjamin, *DOL Rule or Not, Be Prepared To Defend Investments, Fees Under a Fiduciary Standard*, INVESTMENTNEWS (Feb. 1, 2017, 6:38 PM), www.investmentnews.com/article/20170201/FREE/170209983/dol-rule-or-not-be-prepared-to-defend-investments-fees-under-a (observing that “[r]egardless of what happens, the cat’s out of the bag now, because clients are more educated” and that “[w]hether the full rule is implemented or delayed, it doesn’t matter to the end user” (quoting Joe Taiber, managing partner of an investment consulting firm)).

21. See Kristina M. Zanotti, *Beyond the Soundbite: Why the New DOL Fiduciary Rule Means More Than Acting in a Client’s Best Interests*, BENEFITS L.J., Summer 2016, at 7 (describing how transaction-based compensation constitutes a prohibited conflict of interest under ERISA).

22. See Daisy Maxey, *Ruling Near on Fiduciary Duty for Brokers*, WALL ST. J.: WEALTH MGMT. (Apr. 13, 2014, 4:51 PM), <http://www.wsj.com/articles/ruling-near-on-fiduciary-duty-for-brokers-1396894687> (noting that brokers often receive commissions as compensation).

compensatory amounts added to securities' market prices.²³ And in recommending and selling shares of mutual funds—the mainstay investment for retirement savers—they often receive front-end sales loads (paid by purchasing investors),²⁴ so-called 12b-1 fees (paid by the funds themselves),²⁵ or revenue sharing payments (typically paid by the funds' managers).²⁶

To be sure, transaction-based compensation structures could incentivize a broker to recommend and execute more transactions on behalf of a customer than what is in the customer's best interests or to recommend investments as to which the commissions or other fees are higher than those associated with other, possibly more suitable, investments.²⁷ That is ERISA's worry, and it is well founded. However, these compensation models also further the interests of investors who trade infrequently (which describes most retirement investors) because they render investment advice more affordable than advice provided in exchange for the asset-based fees²⁸ that registered investment advisers typically receive, which the DOL generally deems acceptable.²⁹ This is a critical point, moreover, because investors who

23. See *Markup*, INVESTOPEDIA, <http://www.investopedia.com/terms/m/markup.asp> (last visited Sept. 1, 2017) (“Markups occur when dealers act as principals, buying and selling securities from their own accounts at their own risk, as opposed to brokers receiving a fee for facilitating a transaction.”).

24. See *Front-End Load*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/front-endload.asp> (last visited Sept. 1, 2017) (noting that “[a] front-end load is a commission or sales charge” that is often applied in connection with an investor's purchase of mutual fund shares).

25. See *Mutual Fund Fees and Expenses*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/fast-answers/answersmfteeshtm.html> (last modified Jan. 15, 2013) (noting that mutual funds pay 12b-1 fees to “compensat[e] brokers and others who sell fund shares”).

26. See Dan Jamieson, *Broker-Dealers Derive Big Income from Revenue-Sharing Deals*, FIN. ADVISOR (May 11, 2015), <http://www.fa-mag.com/news/broker-dealers-derive-big-income-from-revenue-sharing-deals-21717.html> (“Revenue-sharing fees are paid by all types of product sponsors directly to [broker-dealers].”).

27. See, e.g., Jason Van Bergen, *Paying Your Investment Advisor—Fees or Commissions?*, INVESTOPEDIA, <http://www.investopedia.com/articles/basics/04/022704.asp> (last visited Sept. 1, 2017) (“[T]o increase their commissions, some brokers practice churning, the unethical practice of excessively buying and selling securities in a client's account.”).

28. An asset-based fee is one that is paid periodically (usually monthly or quarterly) and that equals a designated percentage of the assets as to which the customer receives advice. *Definition of Asset-Based Fee*, PALADIN RES. & REGISTRY, <https://www.paladinregistry.com/financial-dictionary/asset-based-fee?letter=A> (last visited Aug. 31, 2017) (defining an asset-based fee as “[a] fee that is charged by financial advisors that is a percentage of their client's assets”).

29. See Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,011 n.18 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2550) (opining that an adviser's “ongoing receipt of

rely on investment advice from financial professionals tend to save more and realize better investment performance than those who do not procure such advice.³⁰

Nevertheless, as this Article contends, this tension—between, on the one hand, eliminating conflicts of interest that might harm retirement investors and, on the other, forcing them to pay more for investment advice—does not end in a draw. Rather, by way of its reformation of many advisers' (securities brokers') relationships with their retirement-investor customers, the fiduciary rule imperils investors in ways that are not immediately evident and, indeed, that other scholars and observers have not noticed.³¹ These subtle but significant effects stem from the fact that the rule encourages a particular approach to investing or, in industry parlance, a particular investment strategy. That is, by making broker-supplied advice more expensive, it incentivizes advisers to recommend low-cost, passively managed products such as exchange-traded funds (ETFs) and index funds—products that aim to achieve returns that mirror the returns of particular markets or indices and therefore do not rely on their managers' ability to actively select high-performing portfolio positions.³²

This response makes sense under the logic that, if the advice that brokers provide becomes more expensive as a result of these advisers' adoption of asset-based or other types of compensation models, then costs that investors bear elsewhere in the investment chain should be lowered to make up the difference. However, it harms retirement investors. For one thing, despite the benefit of passively managed investment strategies, actively managed strategies remain critical for achieving optimal returns and portfolio diversification.³³ More

compensation based on a fixed percentage of the value of assets under management does not require a prohibited transaction exemption").

30. See Chamber of Commerce Complaint, *supra* note 14, at 3.

31. Indeed, no other scholar has evaluated the fiduciary rule beyond reporting concerns previously raised by the rule's critics, despite the tremendous controversy that the rule has generated throughout the financial industry and beyond. See, e.g., Harvey Bines & Steve Thel, *The Varieties of Investment Management Law*, 21 *FORDHAM J. CORP. & FIN. L.* 71, 108-11 (2016) (summarizing various aspects of the rule); Roberta S. Karmel, *The Challenge of Fiduciary Regulation: The Investment Advisers Act After Seventy-Five Years*, 10 *BROOK. J. CORP. FIN. & COM. L.* 405, 423-25 (2016) (noting the rule and summarizing some of the criticisms against it); Paul M. Secunda, *The Behavioral Economic Case for Paternalistic Workplace Retirement Plans*, 91 *IND. L.J.* 505, 543 (2016) (briefly referring to the rule in a broader discussion about the Australian pension scheme).

32. See *infra* notes 122-124, 128-133 and accompanying text.

33. See *infra* notes 148-150 and accompanying text.

important, through setting in motion a push toward passive management, the rule portends an investment universe in which there is no need for retirement investors to choose among investment options—for there is only the one option. In this universe, there is also no need for individually tailored investment advice, and the notion that advisers have fiduciary obligations no longer has meaning. The rule also portends, therefore, a constriction of most retirement investors' participation in the securities markets and a still-wider gap, in terms of investment opportunities and performance, between retirement investors and their sophisticated counterparts, who generally do not rely on broker-supplied advice.³⁴

Given the damage that the fiduciary rule threatens to inflict on retirement investors, the DOL's adoption of it is an episode of failed rulemaking—one that, this Article contends, may be traced to doctrinal factors. First, the rule is inconsistent with securities regulation's foundational principle. In enacting the securities laws in the Great Depression's aftermath, Congress rejected an approach that would require regulators to pass judgment on the substance, or merits, of any particular endeavor.³⁵ It did so, among other reasons, because it reasonably discerned that such an approach could hinder efficient capital allocation, harming both investors and the capital formation process.³⁶ Instead, it adopted a regulatory regime in which regulatory subjects need only comply with specified procedural requirements—disclosure requirements, in particular—and to always be truthful in doing so.³⁷ Congress thus embraced regulatory neutrality as its foundational principle and adopted transparency as its pivotal regulatory tool.

In contrast, with the fiduciary rule, the DOL implicitly passes judgment on both the worth of actively—and passively—managed strategies and the nature and scope of retirement investors' participation in the securities markets. It therefore furthers a vision of

34. See *infra* notes 145-146, 151-156 and accompanying text.

35. See Arthur B. Laby, *Models of Securities Regulation in the United States*, 23 *FORDHAM INT'L L.J.* S20 n.2 (2000) (observing that Congress considered but ultimately rejected “[m]erit based regulation of public companies . . . in favor of disclosure”).

36. See Rutheford B. Campbell Jr., *An Open Attack on the Nonsense of Blue Sky Regulation*, 10 *J. CORP. L.* 553, 565 (1985) (“[M]erit regulation unnecessarily constrains the freedom of people to do business as they see fit, discourages entrepreneurial initiative and impedes the flow of capital to its most efficient use.”).

37. See *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953) (“The design of the [Securities Act] is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.”).

securities regulation that is at odds with Congress's emphasis on neutrality and effectively drops a foreign organism into a generally self-contained and self-referencing system. The rule harms investors because that system cannot accommodate it and, further, lacks the means to counter its effects in other ways.

Second, the rule ignores securities regulation's core challenge, which this Article identifies as controlling, without necessarily eliminating, conflicts of interest—that is, the incentives of issuers, financial professionals, and others with information advantages to further their own interests at the expense of investors' interests. This concern, which reflects a recognition that regulation should not so heavily dictate procedure that these market participants can no longer pursue activities that contribute to economic and capital growth, led Congress to adopt regulatory approaches that balanced competing interests: those who have information advantages may proceed with conflict-causing (but market-benefiting) activities but with caveats that impose limits or that mandate disclosure or other specific protections.

Although the fiduciary rule is expressly based on the goal of protecting investors from their advisers' conflicts of interest, the DOL eschewed the pragmatic approach on which securities regulation has relied for so long and instead opted to eliminate conflicts altogether. Yet by cutting off a category of economically productive activity—the broker-retirement investor advisory relationship and the per transaction compensation on which it has historically relied—the rule sends advisers looking for a “second best” business model that ultimately cannot be found. Rather, in place of this relationship there is a hastily constructed arrangement in which the financial costs associated with any particular investment is the sole determinant of whether the investment is good or bad or somewhere in between.

The dissonance characterizing the DOL's latest securities regulatory initiative provides lessons beyond the securities regulatory realm, however. It also demonstrates that shared regulatory authority may fail due to a factor beyond the duplication, confusion, and inefficiencies that shared authority has often created.³⁸ It may fail, that is, because it does not satisfy a structural precondition that the scholarly literature on shared regulatory authority has not heretofore

38. See Todd S. Aagaard, *Regulatory Overlap, Overlapping Legal Fields, and Statutory Discontinuities*, 29 VA. ENVTL. L.J. 237, 238-39 (2011) (describing common criticisms of shared regulatory authority).

recognized—namely, consonance in the two regulators’ norms and goals.³⁹ This precondition does not exist in the case of the authority that the DOL and the SEC share, and the fact that previous DOL rulemaking under ERISA has not produced the harm that the present case study highlights is arguably only a matter of happenstance.

Although the attitudinal divide separating regulators with shared authority may seem less severe in other rulemaking to date, the ongoing expansion of the regulatory state means that policymaking vigilance is critical. Accordingly, as its coda, this Article offers suggestions for avoiding similar circumstances in the future.⁴⁰ Moreover, to return to the concerns at hand, it also offers a better approach for protecting retirement investors from their advisers’ conflicts of interest and avoiding harm either to them or to a securities regulatory regime, that, while worthy of much criticism, has gotten some things right.

This Article proceeds in three parts. Providing the foundation for the Parts that follow, Part II describes the regulatory structure governing employee benefit plans and IRAs and the DOL’s role within that structure. It additionally explains the heretofore important role that securities brokers have played in advising retirement investors and the contours of the DOL’s new fiduciary rule. Part III turns to the ways in which the fiduciary rule redounds to investors’ detriment, showing how the rule implicitly promotes passive investing, regardless of whether such an investment approach is optimal for most investors or in all circumstances. This Part further deploys a thought experiment to contend that, as a result of its impact on portfolio allocation, the rule encourages advisers to opt out of securities regulation and serves to exclude investors from greater securities market participation. Focusing on the doctrinal bases of the rule’s impact, Part IV asserts that the regulatory approach and attitude that spawned the rule is inconsistent not only with the foundational principle of securities regulation, which is neutrality, but also its core challenge, which is to mitigate conflicts of interest. It concludes, however, that the difficulties surrounding the fiduciary rule provide important lessons for policymakers as they produce additional instances of shared regulatory authority and important lessons for the DOL in its future regulation of the securities markets and its participants.

39. See *infra* notes 194-203 and accompanying text.

40. See *infra* notes 205-209 and accompanying text.

II. SECURITIES REGULATION BY ANOTHER NAME

It is axiomatic that Congress created different regulatory bodies to serve different purposes. Accordingly, the function of the Department of Labor, a cabinet-level department since 1913, is to improve the well-being of workers and retirees, promote safe working conditions, and ensure the availability of employment-related rights and benefits.⁴¹ As part of this mission, the DOL is responsible for administering ERISA, the federal statute that aims to protect participants in employee benefit plans.⁴² Meanwhile, the function of the Securities and Exchange Commission, as the agency charged with implementing and enforcing the federal securities laws, is to regulate the country's securities markets and stock exchanges, with a view toward protecting investors, promoting market integrity and stability, and fostering capital formation.⁴³

And never the twain shall meet—or so one might imagine based simply on the two agencies' strikingly different responsibilities and objectives. However, there is overlap between the regulatory regimes governing employee benefit plans, on the one hand, and the securities markets, on the other. That is an inevitable product of the fact that ERISA and the DOL's rules under ERISA govern certain securities professionals' activities, insofar as the assets of employee benefit plans (plan assets) or IRA accounts are involved.⁴⁴ Moreover, the DOL has rigorously exercised its securities regulatory authority, most recently adopting a rule that has profound implications for both securities investors and the securities markets more broadly.⁴⁵ This Part sets the stage for Part III's discussion of the new rule's impact. Part II.A delves into ERISA—its structure and coverage, including the obligations it imposes on those who are deemed fiduciaries—and the DOL's role in administering it, while Part II.B discusses what the new rule requires and how it promises to dramatically change how

41. See Judson MacLaury, *A Brief History: The U.S. Department of Labor*, U.S. DEP'T LAB., <https://www.dol.gov/oasam/programs/history/dolhistoxford.htm> (last visited Aug. 30, 2017) (describing the DOL's history and functions).

42. See *id.* (“[ERISA] gave the Department a major role in protecting and improving the nation's private retirement systems.”).

43. See *What We Do*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/Article/whatwedo.html> (last modified June 10, 2013) (describing the SEC's objectives and functions).

44. EMP. BENEFITS SEC. ADMIN., DEP'T OF LABOR, MEETING YOUR FIDUCIARY RESPONSIBILITIES 1-4 (2012), <http://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/meeting-your-fiduciary-responsibilities.pdf>.

45. See Hersch, *supra* note 15.

thousands of securities professionals operate *vis-à-vis* retirement investors.

A. ERISA and the DOL's Rules

ERISA was Congress's response to a number of problems stemming from how employers operated the employee benefit plans that they sponsored. Most notably, many employers, in violation of their contractual obligations, had failed to fund their plans, thereby depriving participants of payments and benefits on which they had relied to support them in their postemployment years.⁴⁶ To address these deficiencies, ERISA requires, among other things, that plans provide a complaint and appeals process for participants claiming plan benefits and allows plan participants to sue various parties based on the latter's failure to perform their duties under the statute.⁴⁷ ERISA also subjects plan sponsors to extensive reporting and disclosure requirements.⁴⁸

However, it is the statute's fiduciary provisions that intersect with securities regulation and that are increasingly inconsistent with it. ERISA provides that a person is a fiduciary to an employee benefit plan if she engages in at least one of three types of activities, including "render[ing] investment advice for a fee or other compensation . . . with respect to any moneys or other property of such plan."⁴⁹ Although advisers who are registered with the SEC as investment advisers and regulated as such under the securities laws (registered investment advisers)—who exist solely to provide investment advice to their clients—are ERISA fiduciaries under this description, it has been less clear whether securities brokers similarly are, given that the advice they provide is often sporadic and merely incidental to their brokerage services.⁵⁰

46. See Jonathan Barry Forman, *Employee Retirement Income Security Act*, ENCYCLOPEDIA.COM, <http://www.encyclopedia.com/social-sciences-and-law/economics-business-and-labor/businesses-and-occupations/employee-retirement> (last visited Aug. 24, 2017) (describing the types of problems that necessitated ERISA).

47. See ERISA, U.S. DEP'T LAB., <https://www.dol.gov/general/topic/retirement/erisa> (last visited Aug. 28, 2017) (summarizing ERISA's content).

48. See *id.*

49. ERISA, 29 U.S.C. § 1002(21)(A) (2012).

50. See LAURA PAGLIA, TORYS LLP, STANDARD OF CONDUCT FOR ADVISORS AND DEALERS: EXPLORING THE APPROPRIATENESS OF INTRODUCING A STATUTORY BEST INTEREST DUTY WHEN ADVICE IS PROVIDED TO RETAIL CLIENTS 3 (2013), <https://www.ific.ca/wp-content/uploads/2013/12/CSA-Consultation-Paper-33-403-a-legal-analysis-by-Laura-Paglia-Torlys-November-11-2013.pdf/6255/> ("[T]he U.S. makes a distinction between 'broker-dealers' who provide more incidental and sporadic advice and 'investment advisors' who

Congress gave the DOL authority to resolve the ambiguity—the question of what sort of investment advice gives rise to the type of relationship that should render an adviser an ERISA fiduciary—by granting the DOL the authority to define “accounting, technical and trade terms” that the statute uses.⁵¹ Accordingly, in 1975 the DOL adopted a rule setting forth five characteristics that must be present in order for an adviser to be deemed to be providing investment advice as used in ERISA’s definition of fiduciary. Specifically, the adviser must be (1) providing advice as to “the value of securities or other property, or mak[ing] recommendation[s] as to the advisability of investing in, purchasing, or selling securities or other property,” (2) on a regular basis and, (3) “pursuant to a mutual agreement, arrangement or understanding” between the adviser and an employee benefit plan, (4) “that such services will serve as a primary basis for investment decisions with respect to” the plan’s assets, and (5) that the adviser “will render individualized investment advice to the plan based on the particular needs of the plan.”⁵²

In its articulation of these five characteristics, the DOL effectively defined investment advice in a manner that accords with longstanding doctrine under the securities laws.⁵³ In particular, because the DOL’s definition provides that advice is not investment advice unless it is tailored to the needs of the relevant investor and provided on a regular basis pursuant to a mutual agreement between adviser and investor, it generally captures only those who are registered investment advisers⁵⁴—and who, under the securities laws, are already fiduciaries to those they advise.⁵⁵ By contrast, because the

provide ongoing advice on a portfolio basis, each in turn subject to different regulatory and statutory regimes.”).

51. 29 U.S.C. § 1135.

52. Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,954 n.15 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2510.3-21(c)).

53. 15 U.S.C. § 80a.

54. Under the securities laws, an “investment adviser” is someone who “for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.” *Id.* § 80b-2(a)(11). Among an investment adviser’s basic functions is “furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments.” *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 187 (1963).

55. See *Capital Gains Research Bureau, Inc.*, 375 U.S. at 191 (highlighting how Congress deemed those who qualify as “investment advisers” to be fiduciaries to their clients).

definition does not encompass those who provide sporadic advice regarding securities or other investment products or who have disavowed any mutual understanding that their advice is based on the relevant investor's needs,⁵⁶ it generally does not capture those who are securities brokers under the securities laws—and who, under those laws, are *not* already fiduciaries to those they advise.⁵⁷

That the 1975 definition generally does not encompass securities brokers has been fortuitous for those professionals because of the implications of being a fiduciary under ERISA. As an initial matter, ERISA prohibits fiduciaries from engaging in three different types of conflict of interest transactions in connection with advising an employee benefit plan: dealing with the plan's assets in the fiduciary's own interest or for her own account, acting on behalf of a party whose interests are adverse to those of the plan or its participants or beneficiaries in any transaction involving the plan, and receiving any consideration for her own account from anyone dealing with the plan in a transaction involving the plan's assets.⁵⁸ Moreover, ERISA contains a second set of prohibited transaction rules, which apply not only to fiduciaries but also to service providers to an employee benefit plan who do not qualify as fiduciaries, such as plan administrators and accountants.⁵⁹

Taken together, these transaction prohibitions are substantially broader than the prohibitions that the securities laws and rules impose on advisers who are fiduciaries under the securities laws.⁶⁰ They prevent fiduciaries who provide investment advice to a plan or its participants from advising the plan as to a wide range of investment and trading activities—activities that are not prohibited under the securities laws.⁶¹ For example, a securities fiduciary is able to cause

56. See Zanotti, *supra* note 21, at 5 (describing how financial professionals who did not meet certain elements of the DOL's five-part test avoided being ERISA fiduciaries).

57. See Maxey, *supra* note 22 (noting that securities brokers are not fiduciaries).

58. See 29 U.S.C. § 1106(b) (“Transactions between plan and fiduciary.”).

59. See *id.* § 1106(a) (“Transactions between plan and party in interest.”). These “party-in-interest” prohibited transaction rules prohibit fiduciaries and other parties-in-interest from, among other things, “caus[ing] the plan to engage a transaction” if the transaction constitutes a sale or exchange of any property, the lending of money, or the furnishing of “goods, services, or facilities” between the plan and a party-in-interest. *Id.*

60. See David C. Kaleda, *What It Means To Be an ERISA Fiduciary: A Comparison to the Securities Laws*, NAT'L SOC'Y COMPLIANCE PROF. CURRENTS, May/June 2013, at 10-13, http://www.groom.com/media/publication/1269_ERISA_Fiduciary_Comparison_to_Securities_Laws.pdf.

61. Cf. David C. Kaleda, *Do You Really Want to Do That? IRAs and the Prohibited Transaction Provisions*, INV. LAW., May 2012, at 4 (observing with regard to equivalent

two accounts to enter into transactions in which one account sells a security to the other (a cross trade) if the fiduciary complies with certain procedures and believes the transaction to be in the best interests of both accounts.⁶² However, ERISA prohibits such transactions (insofar as a plan assets account is involved) on the basis that the fiduciary is representing a party (the other account) whose interests are adverse to the plan's interests.⁶³ In addition, although causing a plan to sell securities short⁶⁴ is not necessarily problematic under the securities laws, ERISA prohibits such transactions because the counterparty—that is, the institution lending the securities to be sold short—is typically a party-in-interest as a result of other services that it provides to the plan.⁶⁵ Still, prior to the DOL's adoption of the rule described below, these more stringent fiduciary requirements did not substantially alter ERISA fiduciaries' business models or ability to provide their services, largely because of how most fiduciaries (again, mostly registered investment advisers) were compensated.⁶⁶

Nevertheless, to address the circumstance that rules designed to protect plan participants could actually counter participants' interests,

prohibitions in the Internal Revenue Code that “[t]he statute essentially starts with the premise that most transactions” involving retirement assets are impermissible).

62. Les Abromovitz, *Agency and Principal Transactions*, THINKADVISOR (Jan. 1, 2012), <http://www.thinkadvisor.com/2012/01/01/agency-and-principal-transactions> (observing that under the securities laws, “there is no prohibition from engaging in principal and agency [cross] transactions,” but that, in effecting a cross trade, an investment adviser “must satisfy a disclosure and client consent requirement”).

63. See EVERSLEDs SUTHERLAND, DOL ISSUES FINAL REGULATIONS UNDER ERISA CROSS TRADE EXEMPTION 1 (Oct. 21, 2008), <http://us.eversheds-sutherland.com/portal/resource/lookup/poid/Z1tO19NPtuKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEtGpDt0!/fileUpload.name=/EmpBenAlertDOLIssuesFinalRegs102108.pdf> (“DOL’s view is that a cross trade gives rise to [a] prohibited transaction . . . inasmuch as the adviser or manager is ‘representing’ both sides of the transaction.”).

64. A short sale involves selling a publicly traded security that the seller borrowed from someone else (usually a financial institution) in hopes that the price of the security will thereafter decrease. If it does so, then, when the seller buys the security in order to pay off her loan, she will retain as profit the difference between the price at which she sold the security and the price at which she later purchased it. See Matthew Lewis, Comment, *A Transatlantic Dilemma: A Comparative Review of American and British Hedge Fund Regulation*, 22 EMORY INT’L L. REV. 347, 358 (2008) (describing the process of selling securities short).

65. See SCHULTE ROTH & ZABEL, LLP, ERISA: FROM NO PLAN ASSETS TO MANAGING PLAN ASSETS 3, 5 (Jan. 21, 2015), <https://www.srz.com/images/content/1/3/v2/139880/012115-SRZ-PIF-2016-ERISA.pdf> (noting that “[l]oans and other extensions of credit, including margin loans and short sales” are prohibited under ERISA).

66. See *infra* notes 82-86 and accompanying text (noting that registered investment advisers typically receive asset-based fees, rather than transaction-based fees).

ERISA also contains a number of exemptions to its prohibitions.⁶⁷ In addition, the DOL, pursuant to its authority under ERISA,⁶⁸ has adopted a number of additional exemptions.⁶⁹ Indeed, issuing such exemptions is arguably the DOL's signal role in terms of administering ERISA, given that, apart from its authority to adopt exemptions and define terms, Congress granted the DOL little substantive authority under the statute.⁷⁰ As a result of its circumscribed authority, for example, the DOL cannot establish its own prohibited transaction rules—or, at least it cannot do so directly.⁷¹ As the next subpart discusses, however, in 2016 the DOL used its powers to define terms and exempt otherwise prohibited transactions to establish, indirectly, new requirements that are substantially changing the way that the securities markets operate.

A final point bears mentioning. ERISA largely pertains only to employee benefit plans; it does not cover IRAs or, therefore, IRA fiduciaries' obligations as to those accounts.⁷² This is consistent with the fact that employee benefit plans, but not IRAs, are closely related to the statute's eponymous goal of ensuring "employee retirement income security." Rather, another statute entirely—the Internal Revenue Code—covers IRAs and contains fiduciary provisions that closely mirror ERISA's.⁷³ However, although the Internal Revenue Service is generally responsible for administering the Code, a 1978 executive statement granted the DOL authority, equivalent to its authority under ERISA, to interpret the fiduciary definition under the Code and to adopt prohibited transaction exemptions covering advice

67. See ERISA, 29 U.S.C. § 1108 (2012) ("Exemptions from prohibited transactions"). Under one of the more important statutory exemptions, a party-in-interest may enter into certain types of transactions with a plan so long as the plan pays the party no more than "reasonable compensation." *Id.*

68. See *id.* Specifically, the DOL may grant an exemption if the exemption is "(1) administratively feasible, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of such plan." *Id.*

69. See *Class Exemptions*, U.S. DEP'T LAB., <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/exemptions/class> (last visited Aug. 31, 2017) (listing the DOL's exemptions under ERISA).

70. See 29 U.S.C. § 1135 (delegating authority to the DOL).

71. See *id.* §§ 1108, 1135.

72. See *Important ERISA Issues*, INVESTOPEDIA, <http://www.investopedia.com/exam-guide/series-66/retirement-plans/erisa-issues.asp> (last visited Aug. 31, 2017) ("IRAs are not subject to ERISA, since an IRA is not considered an employer plan.")

73. See 26 U.S.C. § 4975(c) ("Tax on prohibited transactions").

that fiduciaries provide to IRAs.⁷⁴ Accordingly, most of the DOL's rules under ERISA—those pertaining to fiduciaries, at least—encompass both employee benefit plan participants and IRA owners. Given that trillions of dollars are now invested through IRAs,⁷⁵ this expanded rulemaking authority renders the DOL's recent rulemaking all the more troublesome.

B. *The Fiduciary Rule*

As the previous subpart details, an adviser that qualifies as a fiduciary under ERISA becomes subject to a wide array of constraints, all of which are aimed at ensuring the fiduciary's undivided loyalty to the employee benefit plans that she advises. Until recently, only those advisers who met the definition of "investment adviser" under the securities laws—and whom the SEC regulates under those laws—fell within the definition of ERISA fiduciary and became subject to the associated obligations. In 2016, however, the DOL adopted a new rule that brings a wholly different type of adviser within the definition of fiduciary, subjecting them to the prohibited transaction rules to which many registered investment advisers have long been subject. These other advisers are securities brokers, who have traditionally operated in a manner very different from how registered investment advisers have operated.

Securities brokers, who are regulated under the securities laws as "broker-dealers,"⁷⁶ specialize in transacting in securities, whereby they stand between buyers and sellers of securities.⁷⁷ However, they frequently also provide investment advice to these buyers and sellers of securities.⁷⁸ Indeed, many financial firms whose names we often associate with investment advisory services rather than transaction execution services, including Edward Jones and Charles Schwab, are

74. See Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47,713 (Oct. 16, 1978), reprinted in 5 U.S.C. app. at 237 (2012), and in 92 Stat. 3790 (1978).

75. See Thornton, *supra* note 4 ("IRAs account for the greatest share of [retirement] assets at \$7.6 trillion . . .").

76. See 15 U.S.C. § 78o.

77. See Lisa Smith, *What Is a "Broker-Dealer" and Why Should You Care?*, INVESTOPEDIA, <http://www.investopedia.com/articles/investing/072913/what-brokerdealer-and-why-should-you-care.asp> (last visited Aug. 31, 2017) (noting that "[a] broker executes orders on behalf of clients" and "facilitates security trading as an 'agent' acting on behalf of investors").

78. See *id.* ("[Full-service brokers] provid[e] specific investment recommendations in addition to planning and advice services that range from retirement planning, long-term care planning and estate planning to the formulation of personal investment strategy . . .").

regulated not as investment advisers but as broker-dealers. Under the securities laws, these firms are able to provide investment advice without having to be regulated as investment advisers so long as such advice is solely incidental to the firms' brokerage services, and the firms receive no special compensation for providing it.⁷⁹ Moreover, unless a brokerage firm is also regulated as an investment adviser, neither it nor its advisory personnel—that is, its individual brokers—are fiduciaries to their customers.⁸⁰ This means that, in making investment recommendations, they need not have a single-minded focus on their customers' best interests,⁸¹ a circumstance that is consistent with the notion that, fundamentally, a broker's purpose is not to provide investment advice but, rather, to sell securities. Simply put, brokers are salespersons.

Historically, many retirement investors who obtained investment advice in connection with their securities transactions did so from securities brokers, rather than from registered investment advisers, notwithstanding that the former were not subject to fiduciary obligations.⁸² For one thing, the investment advice that securities brokers dispensed was generally more affordable than advice provided by investment advisers.⁸³ Because brokers could receive transaction-based compensation—in the form of commissions or, to the extent they recommended particular mutual funds, sales loads, revenue-sharing payments, or so-called 12b-1 fees—their customers bore a

79. See Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 723 (2012).

80. See Brett Carson, *Is Your Financial Advisor a Fiduciary?*, U.S. NEWS: MONEY (Mar. 19, 2015, 12:38 PM), <http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2015/03/19/is-your-financial-advisor-a-fiduciary> (observing that “broker dealers” are not subject to a “fiduciary standard”).

81. See *id.* Nonetheless, under Exchange Act and FINRA rules, securities brokers must act in accordance with (nonfiduciary) standards of conduct, including that any recommendation that a customer transact in a particular security or pursue a particular investment strategy be “suitable” for the customer, in light of the customer's particular circumstances, such as wealth, age, investment experience, and financial needs. See Laby, *supra* note 79, at 710 (“When recommending securities, a broker-dealer owes a duty of suitability, which is a duty to ensure that an investment recommendation or strategy is suitable for a particular individual at a particular time.”).

82. See Maxey, *supra* note 22 (discussing concerns associated with brokers' provision of investment advice).

83. See Chamber of Commerce Complaint, *supra* note 14, at 32 (“[C]onsumers with ‘low trading activity and no need for ongoing monitoring or advice’ fare better with a transaction-based model rather than a[n] [asset]-based model because the latter is more costly and results in recurring charges.” (citation omitted)).

one-time cost for the advice they received.⁸⁴ This form of compensation stood in contrast to the compensation associated with registered investment advisers, who typically receive an ongoing fee, usually paid monthly or quarterly, based on the amount of assets as to which they provide advice.⁸⁵ For most retirement investors, brokers' pay-as-you-go format worked better than an asset-based model, because these investors generally do not buy and sell securities frequently but instead pursue traditional buy-and-hold strategies.⁸⁶

In addition, most retirement investors are financially precluded from engaging the services of registered investment advisers, who typically require that their clients have a minimum amount of assets as to which they desire investment advice.⁸⁷ These requirements arise from the fact that registered investment advisers generally provide comprehensive advisory services on a continuous basis. Accordingly, it is often not cost effective for them to advise small accounts.⁸⁸ Securities brokers, by contrast, generally have not imposed minimum asset requirements—and, indeed, there has been no need for them to do so, given a business model in which a onetime recommendation was exchanged for a onetime fee.

84. See *supra* notes 22-26 and accompanying text (describing the types of (transaction-based) compensation that brokers receive).

85. See Daisy Maxey, *How To Pay Your Financial Adviser*, WALL ST. J.: WEALTH MGMT. (Dec. 12, 2011), <http://www.wsj.com/articles/how-to-pay-your-financial-adviser-1378302678> (describing asset-based fees).

86. See Jason Van Bergen, *Paying Your Investment Advisor—Fees or Commissions?*, INVESTOPEDIA, <http://www.investopedia.com/articles/basics/04/022704.asp> (last visited Sept. 1, 2017) (noting that transaction-based fees are often more appropriate than asset-based fees “in the case of a smaller portfolio where less active management is required”). To be sure, transaction-based compensation may create risks. Most notably, an adviser may engage in “churning,” whereby the adviser seeks to increase the aggregate fees she receives by advising customers to trade more frequently than what would best serve the customers’ interests. See *id.* (“[T]o increase their commissions, some brokers practice churning, the unethical practice of excessively buying and selling securities in a client’s account.”). However, asset-based compensation creates a risk of “reverse churning,” whereby an adviser makes too few recommendations, knowing that she will be paid her periodic fee either way. See Judith Burns, *Financial Planners Ask SEC To Limit Brokers’ Role*, WALL ST. J.: MONEY (June 23, 2004, 12:01 AM), <http://www.wsj.com/articles/SB108794599485744704> (“While [asset]-based accounts eliminate incentives for brokers to engage in . . . churning, critics say the accounts have spawned ‘reverse churning,’ in which . . . customers pay hefty asset-based fees and get little in return.”).

87. See Maxey, *supra* note 85 (“Many asset-based advisers require account minimums of at least \$500,000 to \$1 million, shutting many investors out.”).

88. See Marla Brill, *How To Afford an Investment Adviser Without Breaking the Bank*, REUTERS (Dec. 13, 2011, 9:41 AM), www.reuters.com/article/us-usa-investing-adviser/how-to-afford-an-investment-adviser-without-breaking-the-bank-idUSTRE7BC1AN20111213.

Regardless of whether retirement investors were well or poorly served by securities brokers' decades-old business model and the transaction-based compensation on which it relied, the question is now moot. The DOL's fiduciary rule requires that brokers—as newly anointed fiduciaries to any employee benefit plan participants or IRA owners they might advise—change how they operate because, like all ERISA fiduciaries, they are now prohibited from receiving transaction-based compensation.⁸⁹ Such compensation is problematic under ERISA because, among other reasons, its amount typically varies based on the particular security, fund, or other product that a broker might recommend and sell. It is differential, in the DOL's characterization.⁹⁰ Because a broker is able to be paid more simply by recommending and selling particular securities over others as to which she would receive less (or no) compensation, it generates the sorts of conflicts of interest that ERISA's prohibited transaction provisions forbid.⁹¹

Yet, given the DOL's limited authority under ERISA, the Department could not frame the rule as a simple proclamation that securities brokers who advise employee benefit plans or IRA accounts were now fiduciaries subject to the prohibited transaction rules.⁹² Rather, using the tools it had, it redefined what constitutes giving investment advice for purposes of ERISA's definition of fiduciary. More specifically, it replaced the definition that it had adopted in 1975—which, recall, accorded with the definition of investment advice under the securities laws⁹³—with a much more encompassing

89. See Zanotti, *supra* note 21, at 5 (observing that under the fiduciary rule, “[w]ithout . . . an exemption, a plan fiduciary would not be able to . . . recommend[] a product with a sales charge that is paid to the fiduciary, without engaging in a prohibited transaction”).

90. See Ian S. Kopelman, *DOL Issues Final Fiduciary Rule and Related Exemptions*, DLA PIPER (Apr. 18, 2016), <https://www.dlapiper.com/en/us/insights/publications/2016/04/dol-issues-final-fiduciary-rule/> (noting that the fiduciary rule prohibits a financial institution's use of “quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause advisers to make recommendations that are not in the best interest of a Retirement Investor”).

91. See Maxey, *supra* note 85 (“When advisers act as brokers, they have an incentive to sell the product that pays the best commission.”).

92. Cf. Chamber of Commerce Complaint, *supra* note 14, at 5-6 (asserting that with the fiduciary rule, “the [DOL] . . . has sought to promulgate this new regulatory regime through its *exemptive* authority under ERISA” and “seeks to convert its authority to *lift* regulatory burdens into a means to *impose* them”).

93. See *supra* notes 54-57 and accompanying text.

definition.⁹⁴ Under this new definition, an adviser provides investment advice to a retirement investor if, among other things, in exchange for a fee or other compensation, she recommends particular securities, investment strategies, or portfolio allocations to the investor.⁹⁵ Because the new definition does not require an agreement or other understanding between an adviser and her customer or that the adviser provide advice on a regular basis, it encompasses the informal and sporadic relationships that often exist between brokers and their customers.

Nevertheless, in a formal nod to the concern that subjecting securities brokers to ERISA's fiduciary obligations would too dramatically impact brokers' businesses, the DOL adopted an exemption—the best-interest contract (BIC) exemption—that would permit advisers to continue to receive transaction-based compensation under certain circumstances. The most important of the BIC exemption's many requirements is that an adviser seeking to rely on it must adhere to “standards of fiduciary conduct and fair dealing” that their customers are entitled to enforce.⁹⁶ In addition, an adviser whose customers are IRA owners—which describes most brokers affected by the fiduciary rule⁹⁷—must enter into an enforceable contract with each customer.⁹⁸ The contract must contain, among other things, extensive representations and warranties by the adviser and extensive disclosures, including regarding all fees and other costs that the customer will bear in connection with a recommended

94. See Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,997 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, 2550) (setting forth the DOL's revised interpretation of “investment advice”).

95. See *id.*

96. Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,003 (Apr. 8, 2016).

97. This is because employee benefit plan participants generally do not receive investment advice in connection with their decisions regarding investing their assets. See Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 48 (2000) (observing that employee benefit plan sponsors generally avoid engaging advisers to assist participants in their investment decisionmaking because doing so subjects the sponsors “to potential co-fiduciary liability”). Accordingly, to the extent that a securities broker provides advice as to the investment of retirement assets, those assets are usually held in IRA accounts. Cf. Michael Wong, *How the DOL's Fiduciary Rule Will Affect Advisors, Investors*, MORNINGSTAR (May 31, 2016, 11:00 AM), <http://www.morningstar.com/cover/videocenter.aspx?id=755683> (noting that the fiduciary rule the rule “primarily affects approximately \$3 trillion of advised IRA assets”).

98. Best Interest Contract Exemption, 81 Fed. Reg. at 21,003 (“In the case of IRAs and non-ERISA plans, the exemption requires that the [fiduciary] standards be set forth in an enforceable contract with the Retirement Investor.”).

transaction and the manner in which the relevant brokerage firm compensates its advisory personnel, and cannot include a class action waiver or require arbitration of individual claims in distant locations.⁹⁹

The BIC exemption, however, does little to alleviate the effects of the fiduciary rule. As an initial matter, as some commentators have noted, the exemption may be so onerous as to be unusable.¹⁰⁰ Yet even without many of its requirements, its usefulness would be open to question: although the exemption permits an adviser to receive transaction-based compensation, to the extent that the compensation differs depending on the particular securities an adviser recommends, the difference must be based on neutral factors¹⁰¹—which presumably means such factors as the amount of time or analytical effort the adviser put into making the recommendation.¹⁰² In other words, compensation cannot be based on the fact that an issuer simply agreed with the adviser or the brokerage firm with which the adviser is affiliated to pay a higher commission or other fee than did another issuer. Because the BIC exemption requires that differential compensation be based on time and effort (or other neutral differences), it is less an exemption than an alternate route through which securities professionals may comply with ERISA's stringent fiduciary obligations.

III. REGULATORY DAMAGE

The fiduciary rule has profound implications for both investors and the securities markets, in that financial advisers who previously were not subject to ERISA's onerous fiduciary obligations must now choose between modifying their business structures to accommodate their new responsibilities and ceasing to advise retirement investors altogether. However, despite the extended concern that the rule has

99. See *id.* at 21,078-80. Under certain circumstances, moreover, brokers must also document, in writing, the reasons for each recommendation. See *id.* at 21,003.

100. See AM. RET. ASS'N, FIDUCIARY RULE RE-PROPOSAL COMPLIANCE COSTS OUTWEIGH BENEFITS 1, <http://www.nts-net.org/Portals/4/15.05.05%20Fiduciary%20Rule%20TPs%20FINAL%20-%20ARA.PDF> (last visited Aug. 26, 2017) (opining that the BIC exemption "is prescriptive, onerous and unworkable"); Charles Paikert, *How DoL Rule May Impact Mutual Funds*, FIN. PLAN. (June 20, 2016, 10:40 AM), <http://www.financial-planning.com/news/how-dol-rule-may-impact-mutual-funds> (noting that advisers likely will not use the BIC exemption because of its "onerous requirements").

101. See Best Interest Contract Exemption, 81 Fed. Reg. at 21,036.

102. See Zanotti, *supra* note 21, at 8 (listing "the difference in time it took the adviser to analyze and provide the advice with respect to different types of investments" as "neutral factors").

caused, certain probable—and harmful—effects of the rule have largely escaped detection. In particular, as Part III.A details, because the fiduciary rule incentivizes newly minted fiduciaries to ensure that aggregate advisory costs borne by retirement investors are as low as possible, these advisers are increasingly recommending passively managed investment strategies and products, avoiding (generally more expensive) actively managed alternatives.¹⁰³ In addition, as Part III.B describes, as a result of this greater market-wide emphasis on passivity, the fiduciary rule also portends a fundamental and worrisome transformation of the role of investment advice in the securities markets—a transformation that will further widen the disparity between retail and sophisticated investors, in terms of investment opportunities and returns.

A. *The DOL's Investment Strategy*

In the new world, in which all financial advisers are fiduciaries to the retirement investors that they advise, advisers must either begin using a compensation model that is not transaction-based or submit to the extensive requirements of the BIC exemption. Regardless of which approach advisers choose, the changes will almost assuredly propel consequential shifts in the allocation of investment assets, substantially increasing the amount allocated to passively managed investment strategies and substantially decreasing the amount allocated to actively managed strategies.¹⁰⁴ Indeed, according to one estimate, by 2021 the rule will have directed over \$1.5 trillion into exchange-traded funds (ETFs) alone.¹⁰⁵ After describing passive investment management and how it differs from active management, this subpart details why the fiduciary rule will likely spur a substantial increase in the amount of assets managed passively.

103. See Melanie Waddell, *DOL, SEC Fee Scrutiny Sparks Shift to Passive Investing*, THINKADVISOR (July 28, 2016), http://www.thinkadvisor.com/2016/07/28/dol-sec-fee-scrutiny-sparks-shift-to-passive-inves?page_all=1.

104. See Madison Marriage, *Obama's 'Fiduciary Rule' Adds to Active Fund Woes*, FIN. TIMES (Sept. 11, 2016), <https://www.ft.com/content/8c88aafc-6528-11e6-8310-ecf0bddad227> (citing various commentators who believe that the fiduciary rule “will accelerate the movement of money out of active strategies and into cheaper passive alternatives”).

105. See BROWN BROS. HARRIMAN, *EXCHANGE THOUGHTS: DOL FIDUCIARY RULE COULD PROPEL \$1.5 TRILLION INTO ETFs* (June 6, 2016), <https://www.bbh.com/blob/16322/6af3a6f0cab0b27af985c6a09cc4754a/exchange-thoughts--dol-fiduciary-rule-could-propel--1-5-trillion-into-etfs-pdf-data.pdf>.

1. Passive Management

Increasingly, amidst the din of disclosures and marketing pitches directed at investors, there is one insistent message: passively managed strategies are best. In other words, investors should aim to put their capital in ETFs, index funds, and related products that hold portfolios consisting of all securities within designated markets or indices and that do not distinguish among particular securities within those markets or indices.¹⁰⁶ Because the securities in a passively managed fund's portfolio should be the same as those within the relevant market or index, the fund's performance over a given period should be the same as the performance of that market or index.¹⁰⁷ By contrast, funds managed pursuant to actively managed strategies invest in only those securities that the funds' managers expect to have superior performance relative to other securities in the same market or index.¹⁰⁸

Economists and asset managers have extolled the virtues of passive management, arguing that investors can hope to do no better than achieve the performance of the securities market as a whole (or, at least, particular components of it).¹⁰⁹ These passivity advocates

106. See Dennis K. Berman & Jamie Heller, *Wall Street's "Do-Nothing" Investing Revolution*, WALL ST. J. (Oct. 17, 2016, 10:30 AM), <http://graphics.wsj.com/passivists/> ("Government mandates, lawsuits and an ever-more available slew of mounting data are leading managers to turn to passive investing as the lower-cost, default options for more Americans each year."); Anne Tergesen & Jason Zweig, *The Dying Business of Picking Stocks*, WALL ST. J.: MKTS. (Oct. 17, 2016, 12:12 PM), <http://www.wsj.com/articles/the-dying-business-of-picking-stocks-1476714749> (noting that "[p]ension funds, endowments, 401(k) retirement plans and retail investors are flooding into passive investment funds, which run on autopilot by tracking an index," while "[s]tock pickers . . . are being pushed to the margins").

107. See *Active vs. Passive Investing: Which Approach Offers Better Returns?*, WHARTON SCH.: ARESTY INST. EXECUTIVE EDUC., <http://executiveeducation.wharton.upenn.edu/thought-leadership/wharton-wealth-management-initiative/wmi-thought-leadership/active-vs-passive-investing-which-approach-offers-better-returns> (last visited Sept. 1, 2017) (referring to "passive investing" as an approach whereby investors "duplicat[e] market returns instead of trying to beat them").

108. See *Active Management*, INVESTOPEDIA, <http://www.investopedia.com/terms/a/activemanagement.asp> (last visited Sept. 1, 2017) (observing that "[a]ctive management is the use of a human element, such as a single manager, co-managers or a team of managers, to actively manage a fund's portfolio" and that "[a]ctive managers rely on analytical research, forecasts, and their own judgment and experience in making investment decisions on what securities to buy, hold and sell").

109. See *Active Versus Passive Investing*, EVANSON ASSET MGMT., <https://www.evansonasset.com/2.htm> (last updated Aug. 2017) ("The 'smart' money uses passive investment strategies."); Spencer Jakob, *Are Fund Managers Doomed? Making the Case for Passive Investing's Triumph*, WALL ST. J.: MKTS. (Oct. 18, 2016, 10:13 AM), <http://www.wsj.com/articles/are-fund-managers-doomed-making-the-case-for-passive-investings-triumph-147679>

concede that, within any market and for any period, actively managed portfolios will *collectively* achieve the same returns as those achieved by a passively managed portfolio. They note, however, that particular actively managed portfolios will perform better than the passively managed portfolio, while others will perform more poorly.¹¹⁰ Accordingly, because the profit earned in some actively managed portfolios will be at the expense of other actively managed portfolios, active management in any given market is a zero-sum game.¹¹¹ In addition, once the higher fees of managers of actively managed strategies are taken into account, passively managed portfolios, which are typically subject to lower fees, will outperform many of the actively managed portfolios that had achieved superior performance before deducting fees.¹¹²

The notion that passive management is preferable to active management also has strong support from dominant theories about how markets function. In particular, the efficient capital markets theory (ECMT) holds that in efficient markets, all publicly available information about a security is reflected in the security's market price.¹¹³ Implications of the theory are, first, that required disclosure under the securities laws and all other publicly available information about a company have no direct relevance for most investors because that information is already reflected in the company's market price and, second, that most investors cannot hope to surpass market returns in their investing activities because it is impossible for them to gain an

8977 (countering arguments against passive management); William F. Sharpe, *Indexed Investing: A Prosaic Way To Beat the Average Investor* (May 1, 2002), https://web.stanford.edu/~wfs Sharpe/art/talks/indexed_investing.htm (discussing the advantages of index funds and ETFs).

110. See Sharpe, *supra* note 109 (observing that because passively managed portfolios achieve the same return as the market, the average actively managed portfolio necessarily also achieves that return).

111. See *Index Investing Makes Markets and Economies More Efficient*, PHIL. ECON. (May 1, 2016), <http://www.philosophicaleconomics.com/2016/05/passive/> (“[S]econdary market trading and investing is a zero-sum game for the participants [in that] [f]or a given market participant to outperform, some other market participant has to underperform.”).

112. See Sharpe, *supra* note 109 (asserting that active managers' fees and costs “are likely to be at least 1.0% (100 basis points) higher than those of passive managers in the same markets” and that this difference impacts relative after-cost returns).

113. See *Efficient Market Hypothesis—EMH*, INVESTOPEDIA, <http://www.investopedia.com/terms/e/efficientmarkethypothesis.asp> (last visited Aug. 29, 2017) (“The efficient market hypothesis (EMH) is an investment theory that states it is impossible to ‘beat the market’ because stock market efficiency causes existing share prices to always incorporate and reflect all relevant information.”).

informational edge over other investors.¹¹⁴ In other words, the ECMT holds that average investors—those who are not financial professionals—cannot “beat” the market.¹¹⁵ And if that is the case, then investing passively is the only reasonable investment option for them.

As one might expect, at various times and in various contexts, economists, scholars, and jurists have argued about the extent to which the theory accurately describes the public securities markets, including the extent to which market prices respond to public information; whether, even if they do, that response produces prices that might be considered accurate; and, even if it does, what “accurate” means in this context.¹¹⁶ As one might further expect, these discussions have not produced answers on which all can agree. However, most observers generally can agree on the principle that, where markets for particular securities are relatively efficient, prices move in response to transactions in those securities, which, for their part, often occur in response to the release of information. This principle, put another way, is simply that efficient markets react to information.¹¹⁷

Despite the range of views on the accuracy of the ECMT, the United States Supreme Court, without explicitly endorsing the theory, has for decades embraced its contentions and conclusions.¹¹⁸ According to the Court in the securities fraud case *Halliburton Co. v. Erica P. John Fund, Inc.*, because “market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices,”¹¹⁹ we can conclude that “most investors . . . will rely on [a] security’s market price as an unbiased assessment of the security’s value in light of all public

114. See Jason Van Bergen, *Efficient Market Hypothesis: Is the Stock Market Efficient?*, INVESTOPEDIA, <http://www.investopedia.com/articles/basics/04/022004.asp> (last visited Aug. 31, 2017) (“[U]nder the efficient market hypothesis, no single investor is ever able to attain greater profitability than another with the same amount of invested funds: their equal possession of information means they can only achieve identical returns.”).

115. See *id.* (“[U]nder the efficient market hypothesis, no investor should ever be able to beat the market, or the average annual returns that all investors and funds are able to achieve using their best efforts.”).

116. See *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2403 (2014).

117. See *Basic Inc. v. Levinson*, 485 U.S. 224, 247 n.24 (1988) (“For purposes of accepting the presumption [that in transacting in public securities, investors rely on the integrity of market prices] in this case, we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.”).

118. See *id.* at 246–47 n.24.

119. 134 S. Ct. at 2410 (quoting *Basic Inc.*, 485 U.S. at 247 n. 24).

information.”¹²⁰ In other words, because, in a “well-developed market,” publicly available information becomes incorporated into a security’s price, courts should presume that, in transacting in the security, investors rely on the “integrity” of that price.¹²¹ The further implication of the Court’s analysis is that, because a security’s market price reflects its actual value, most investors’ portfolios can achieve market returns but cannot do better than that.

2. The Push for Passivity

Of course, neither experts’ explicit advocacy of passive management nor the Supreme Court’s implicit endorsement of it has any particular implications for how financial advisers counsel their retirement-investor customers or how retirement investors deploy their investment assets. The fiduciary rule, by contrast, is substantially more potent on both scores, in that it may be expected to significantly increase the amount of assets that investors allocate to passively managed strategies. More specifically, in two different ways, the rule encourages advisers who, prior to the rule’s adoption, had not been ERISA fiduciaries to advise their retirement-investor customers to invest in passively managed funds and other products.

First, because of the fiduciary rule’s effect on the fees charged by advisers, advisers are increasingly advising their customers to invest in passively managed products in order to maintain customers and market share.¹²² As Part II notes, the fiduciary rule prohibits advisers’ receipt of transaction-based compensation, unless they comply with the myriad requirements of the BIC exemption.¹²³ Advisers who deem the BIC exemption too onerous or otherwise objectionable are therefore transitioning to an asset-based compensation model, in which they are paid a certain percentage of the amount of assets as to which they provide investment advice.¹²⁴ As noted, however, asset-

120. *Id.* at 2409, 2411 (quoting *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 462 (2013)).

121. *Id.* at 2409-11.

122. *See* Waddell, *supra* note 103 (describing the shift in assets from actively managed products to passively managed ones and citing the fiduciary rule as a cause).

123. *See supra* notes 89-102 and accompanying text (discussing the rule’s expected impact on the traditional securities brokerage business model).

124. *See* Mitchell H. Caplan, *The Future of Advisors Is Fee-Based and Tech Obsessed*, FINANCIALPLANNING (May 11, 2016), <http://www.financial-planning.com/opinion/the-future-of-advisors-is-fee-based-and-tech-obsessed> (noting that “[t]he advisory industry has been moving from commission-based sales to fee-based and fee-only advice, and the pace is accelerating” and suggesting that the fiduciary rule is fueling the shift, at least in part).

based fees are generally more expensive for customers—particularly those who do not trade frequently—in part because they are payable on an ongoing basis.¹²⁵ Accordingly, it is reasonable to expect that customers who have historically been subject to per transaction fees but who wish to avoid paying more for investment assistance may forgo advice altogether and to fend for themselves in the securities markets—a phenomenon that the United Kingdom has experienced in connection with regulators’ adoption of a rule similar to the fiduciary rule.¹²⁶

To stanch this potential outflow of customers, advisers are seeking to lower the aggregate fees that a customer must bear. Not only are customers typically subject to the fee charged by their advisers, whether those fees be transaction-based or asset-based, but in their capacities as investors, they are also subject to their pro rata portion of the fees charged by the managers of each mutual fund or other investment product in which they invest.¹²⁷ Advisers have recognized that, given the higher advisory fees that customers would now otherwise pay as a result of the fiduciary rule, recommending that they invest in lower-fee funds and products can help make up the difference.¹²⁸ And, as a general matter, the fees associated with passively managed funds are lower than the fees associated with actively managed ones because the former are less expensive to manage and operate than the latter.¹²⁹ After all, active management requires that fund managers actively research and conduct due diligence on securities and other investment opportunities, which is

125. See *supra* notes 82-86 and accompanying text.

126. See Mark Schoeff Jr., *DOL Fiduciary Opponents Point to UK Experience To Bolster Their Case*, INVESTMENTNEWS (Mar. 19, 2014, 12:01 AM), <http://www.investmentnews.com/article/20140319/FREE/140319907/dol-fiduciary-opponents-point-to-uk-experience-to-bolster-their-case>; HM TREASURY & FIN. CONDUCT AUTH., FINANCIAL ADVICE MARKET REVIEW: FINAL REPORT 5-8 (Mar. 2016), <https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf> (discussing how many investors cannot “currently afford to access the advice they need at a price they are willing or able to pay,” in part because of the “move to fee-based advice on retail investment products”).

127. See BROWN BROS. HARRIMAN, *supra* note 105 (“While investors will pay a fee to their advisor for their service, they are also charged the management fees from the underlying funds the advisor invests in.”).

128. See Tergesen & Zweig, *supra* note 106 (observing that the fiduciary rule will require “[f]inancial advisers overseeing individual retirement accounts . . . to demonstrate that their decisions are in the best interests of their clients” and that these advisers “can help keep overall costs down” by “using index funds in accounts . . . bearing an [asset-based] fee”).

129. See *id.* (“[B]ecause matching the performance of stock indexes is far cheaper than trying to beat them, index funds’ expenses are a fraction of what active funds charge—sometimes 1/30th or less.”).

often expensive in terms of personnel and overhead, and to make investment decisions based on those efforts.¹³⁰ Passive management, on the other hand, involves neither investment selection nor, therefore, the associated costs.

Second, the fact that the fiduciary rule (through the BIC exemption) permits customers to bring class action lawsuits against their advisers for breach of their fiduciary duties may similarly incentivize advisers who rely on the exemption to recommend low-fee, passively managed products more frequently than they had previously.¹³¹ To appreciate why this is so, recall that the DOL's concern in adopting the rule was that, due to conflicts of interests, nonfiduciary advisers did not always recommend products that served their customers' best interests.¹³² Accordingly, an adviser who has been sued for breaching her fiduciary duties must show that her recommendation was, in fact, in the relevant customers' best interests. That may be a more daunting task to the extent that the adviser has recommended higher-fee products, such as actively managed mutual funds, over lower-fee, passively managed options. In other words, advisers' recommendations of passively managed products, by producing lower fees for customers, will likely reduce the risk that advisers are sued for breaches of their fiduciary duties and, if they are sued, the risk that they will lose or otherwise be subject to damages.

To be sure, the magnitude of the fiduciary rule's impact in driving investment capital to passively managed strategies is unclear and will remain unclear for some time. What is clear, however, is that the movement has already begun, accompanied by numerous financial professionals' endorsement of passive management as a means of curbing investment costs that are certain to increase as a result of the rule.¹³³ Therefore, it is also clear that, with the fiduciary

130. See SPDR UNIV., HOW TO INVEST YOUR PORTFOLIO USING PASSIVE AND ACTIVE MANAGEMENT 1 (2010), http://www.lindajblack.com/wp-content/uploads/2011/04/How_to_Invest_Your_Portfolio_Using_Passive_and_Active_Management1.pdf (“[T]o support necessary research and an active trading infrastructure, actively-managed funds spend more money on overhead and staffing, costs that may be reflected in the higher fees charged by active managers . . .”).

131. See BROWN BROS. HARRIMAN, *supra* note 105 (“Given the added litigation risk, advisors may increasingly use lower-cost products like ETFs to reduce the burden of justifying recommendations for higher-priced products.”).

132. See *supra* notes 89-91 and accompanying text.

133. See Madison Marriage, *Passive Funds Take Third of U.S. Market*, FIN. TIMES (Sept. 11, 2016), <https://www.ft.com/content/4cdf2f88-7695-11e6-b60a-de4532d5ea35> (observing that “[t]raditional active fund houses including Franklin Templeton, Legg Mason, Janus Capital and Fidelity have . . . launch[ed] their own benchmark-tracking products, or

rule, the DOL has effectively adopted its own preferred investment strategy and imposed it on large swaths of retirement investors. This result is acutely problematic not only because neither the DOL nor any other regulator is competent to provide investment advice, but also because the Department's preferred strategy may, in many circumstances, counter investors' best interests rather than further them.¹³⁴ As Part IV explains, this result is also inimical to securities regulation's role in the financial markets.

B. *The DOL's Market Distortion*

The DOL's implicit promotion of a particular investment approach is problematic if only because it is contrary to established notions of how securities markets should operate in generally capitalist societies. Yet there is an additional reason to be concerned about the DOL's implicit promotion of passive management: it threatens a further stratification of investors, in which sophisticated investors have the benefit of guidance from fiduciaries and a spectrum of investment opportunities, while retail investors, including most retirement investors, do not. Showing how this is so, this subpart first engages in a thought experiment that reveals how the fiduciary rule, through its promotion of passive management, implicitly disclaims any continued need for investment advice or fiduciary duties. The subpart then posits that this radical investment posture militates against retirement investors' participation in the securities markets and thereby constricts their ability to achieve the returns that such participation can produce.

1. A Thought Experiment

Legislative history shows that, in drafting the Investment Advisers Act of 1940 (the Advisers Act),¹³⁵ the securities statute that governs registered investment advisers, Congress had a particular conception of the investment process. In that conception, investment advisers performed the important service of guiding investors in the sound investment of their assets—a service that was all the more

acquir[ed] smaller passive specialists" to better compete with managers offering lower-cost, passively managed products); Tergesen & Zweig, *supra* note 106 (noting that "[o]ver the past three years, Fidelity . . . has launched nearly two-dozen index mutual funds and ETFs" and citing the fiduciary rule as a contributing factor).

134. See Karmel, *supra* note 31, at 436 ("[N]either the SEC nor the DOL has the competence to determine what advice is in the best interest of the clients.").

135. 15 U.S.C. §§ 80b-1 to 80b-21 (2012).

important given the losses that many investors had suffered in the market crash that precipitated the Great Depression.¹³⁶ Congress further believed that an investment adviser's relationship with her client—the term the Advisers Act uses to refer to a registered investment adviser's customer—was necessarily a personal one, through which the adviser provided advice tailored to the client's particular needs and objectives.¹³⁷ The Supreme Court affirmed this notion in *Lowe v. SEC*¹³⁸ and in *SEC v. Capital Gains Research Bureau, Inc.*,¹³⁹ its two cases to date evaluating the nature of advice provided by a registered investment adviser.¹⁴⁰

The conception of investment advisers as professionals that work closely with each client to develop an investment program consonant with the client's particular needs and objectives is a conception of active management. "Active," after all, is a label that attaches to a wide range of investment and trading strategies and recommendations—all those, in fact, that do not aim to track the performance of a particular market or index.¹⁴¹ This wide range is the expected product of the fact that no single investment approach is right for everyone and that investors must separately evaluate investment options and determine which ones are most suitable for them, given their particular circumstances. Accordingly, active management contemplates that each investor's investment choices—and investment returns—will differ from those of any other investor.

136. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) ("[The Advisers Act] was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930s.").

137. This notion gained support from the many investment advisers who testified in committee hearings on the Advisers Act, who helped shape Congress's belief "that [a] highly personal relationship is of the very essence" of an investment adviser's relationship to her client. See *Investment Trusts and Investment Companies: Hearings Before a Subcomm. of the S. Comm. on Banking & Currency*, 76th Cong. 743 (1940) (statement of Rudolf P. Berle, General Counsel, Investment Counsel Association of America).

138. *Lowe v. SEC*, 472 U.S. 181, 204 (1985).

139. 375 U.S. at 180, 191.

140. See *id.* at 191-92 (quoting 2 LOUIS LOSS, *SECURITIES REGULATION* 1412 (2d ed. 1961)) ("The [Advisers Act] reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship.'"); *Lowe*, 472 U.S. at 207-08 ("The [Advisers] Act was designed to apply to those persons engaged in the investment-advisory profession—those who provide personalized advice attuned to a client's concerns . . .").

141. See Daniel Solin, *Is There a Case for Actively Managed Funds? NO: There Are Winners, but Good Luck Picking Them*, *WALL ST. J.: WEALTH MGMT.* (Mar. 1, 2015, 11:37 PM), <https://www.wsj.com/articles/are-index-funds-really-better-than-actively-managed-1425271058>.

Of course, even passively managed products cannot (for now) be completely passive, holding appropriately weighted positions in every publicly traded security worldwide.¹⁴² Accordingly, passively managed strategies involve at least two types of actively made decisions. First, before any passively managed fund can begin operating, its manager must *actively* select the particular market or index that will define the fund's portfolio and determine its investment performance.¹⁴³ Second, by choosing to buy shares of a particular fund, an investor *actively* chooses to have exposure to a particular market or index, at the expense of having exposure to other markets or indices.¹⁴⁴ Although, in theory, investors whose portfolios comprise passively managed funds will earn "market" returns, the fact that passive management involves actively made decisions means that the performance of each investor's portfolio will differ from the performance of all other investors' portfolios and from the performance of the global, all-encompassing securities market.

But what if passive management *could* be purely passive? In other words, what would be the fiduciary rule's implications if the factors that inhibit pure passivity¹⁴⁵ did not exist and if, therefore, passively managed strategies involved no actively made decisions at all? Considering this question is instructive because of what it reveals about how the fiduciary rule may ultimately constrict the resources available to most retirement investors in allocating their portfolio assets. It is instructive also for what it reveals about the unintended consequences of regulation that is insufficiently informed by the markets to which it applies.

This, then, is the thought experiment. If all passively managed funds were purely passive, holding positions in every security worldwide, exclusive of any component of active management, then there would remain no role at all for investment advice, as that term has been historically understood. That is, if we assume that advice

142. See Cullen Roche, *The Myth of Passive Investing*, PRAGMATIC CAPITALISM, <http://www.pragcap.com/the-myth-of-passive-investing/> (last visited Sept. 1, 2017) ("[W]hen viewed through a macro lens, we all must be active asset pickers . . . because all investors deviate from global cap weighting and essentially pick micro components of the global financial asset portfolio.").

143. See *id.*

144. See *id.* (noting that because "any asset allocator usually begins with cash or no assets at all," the decision to "allocat[e] to other assets is inherently active").

145. That passively managed funds cannot be purely passive is more likely a logistical necessity, arising from the limitations of technology and financial product design, than a theoretical necessity.

constitutes “investment advice” only if it is given within the confines of a personal relationship and is tailored to the particular client or customer to whom it is directed, then such advice is superfluous in a purely passively managed universe because each separate investor that consults a particular adviser should receive the same recommendations. There simply is no personalization or tailoring to do.¹⁴⁶ Additionally, all investors in this universe should have the same ultimate holdings and earn nearly identical returns over any given period, regardless of their individual circumstances. Perhaps just as important, if investment advice in such a universe is obsolete, then so are the fiduciary duties that accompany it. After all, if there is only one investment option, then the concept of duties that can be either upheld or breached is meaningless.

A further implication of this thought experiment is that, with the fiduciary rule, the DOL will have protected retirement investors not by transforming their securities-broker advisers into vigorous fiduciaries but, instead, by making securities regulation irrelevant to both retirement investors and advisers. By directing their retirement-investor customers into passively managed products, advisers will effectively have opted out of providing fiduciary protection, which is just as well given that their customers will no longer require it. Moreover, if retirement investors are better off eschewing active management and instead seeking to earn the market returns that passive management provides, then none of that matters. These investors will achieve the best result possible, with the further benefit that they will no longer need to pay for advice, whether through transaction-based fees, asset-based fees, or otherwise.

2. Exclusionary Implications

In fact, however, retirement investors will arguably be worse off as a result of the transformation of their interaction with the securities markets that the fiduciary rule sets in motion.¹⁴⁷ To begin with, it is far from certain whether passively managed products are the most

146. See Timothy W. Martin, *What Does Nevada's \$35 Billion Fund Manager Do All Day? Nothing*, WALL ST. J.: A-HED (Oct. 19, 2016, 11:13 AM), <http://www.wsj.com/articles/what-does-nevadas-35-billion-fund-manager-do-all-day-nothing-1476887420> (noting that the “daily trading strategy” of the manager of Nevada’s public employee pension fund is to “[d]o as little as possible, usually nothing”).

147. See Michael Fritts, *4 Ways the Fiduciary Rule Could Hurt (Not Help) Investors*, KIPLINGER (July 2017), <http://www.kiplinger.com/article/investing/T023-C032-S014-fiduciary-rule-could-end-up-hurting-investors.html>.

suitable investments for most investors under most circumstances. Despite the lessons of the ECMT, even retail investors are able to potentially beat the market if, as investors often do, they place their money under the management of professional asset managers, such as those that operate mutual funds pursuing actively managed strategies. Although fund managers' efforts to beat the market may be a zero sum game,¹⁴⁸ these professionals are typically at least in a position to be on the winning side of that game more often than not.¹⁴⁹ In addition, as financial advisers have long counseled, active management allows investors to diversify their portfolios across markets and asset classes, helping to protect investors from catastrophic losses during market dislocations that cause all holdings within a particular market or index to lose substantial value.¹⁵⁰

But more is at stake for retirement investors in the market-wide shift to passive management than their ability to invest prudently. In particular, regardless of the extent to which active management is good for investors' portfolios, the broadscale move from active to passive management—and the regulatory changes driving it—defeat securities regulatory objectives. One of those objectives, recall, is protecting investors. Although investor protection is typically associated with the narrow goals of ensuring that investors have access to information regarding possible investments and punishing

148. See *supra* note 111 and accompanying text (describing how some actively managed portfolios achieve above-market returns at the expense of other actively managed portfolios).

149. See Timothy Armour, *You Don't Have To Settle for Average Investing Returns. Here's Why*, WALL ST. J.: MKTS. (Oct. 17, 2016), <http://www.wsj.com/articles/you-dont-have-to-settle-for-average-investing-returns-heres-why-1476717440> (“Research by Capital Group shows that a group of active funds with low expenses and a substantial amount of the manager’s own money invested in the funds on average beat their benchmarks 89% of the time over 10-year rolling periods.”). Some managers using actively managed strategies are successful in doing so because they are able to identify particular securities or sectors are over- or undervalued and to position the funds they manage to take advantage of those insights—for example, to hold short positions in overvalued securities. See Michael Roberge, *Active vs. Passive? Choose Both*, WALL ST. J.: MKTS. (Oct. 17, 2016, 11:14 AM), <http://www.wsj.com/articles/active-vs-passive-choose-both-1476717262> (noting that although “average active manager[s]” may be unable to “beat their benchmark, net of fees” on a consistent basis, “there are skilled active managers who have consistently outperformed their benchmarks over a full market cycle”).

150. See Roberge, *supra* note 149 (observing that “[a]llocating assets to active and passive strategies should be viewed similarly” to “diversify[ing] between stocks and bonds” and that “[i]n periods of higher market volatility . . . active stock picking and strong risk management could . . . help buoy overall portfolio performance”).

those who would defraud them,¹⁵¹ it is closely aligned with a broader goal—namely, deepening investors' involvement in the securities markets by increasing the range of investment opportunities available to them.¹⁵² The processes that the fiduciary rule catalyzes, discussed above, turn this arguably loftier objective on its head because, instead of increasing investment opportunities for investors, they effectively remove most investors—most retirement investors, at least—from the securities markets altogether.

Of course, investing passively is nevertheless investing and necessarily involves the securities markets to that extent. However, it is not the type of participation that Congress envisioned in formulating the securities laws, whereby each investor's activities in the securities markets are determined by her particular needs and objectives and dependent upon the assistance of a qualified adviser, whether in the form of a registered investment adviser or in the form of a securities broker.¹⁵³ Nor is it the type of participation that has long been—and will continue to be—a given for investors who qualify as sophisticated, who have sufficient assets to engage registered investment advisers to manage their accounts and to invest in privately offered products, including hedge funds and private equity funds.¹⁵⁴

Indeed, this is perhaps the most troublesome aspect of the investment trend that the fiduciary rule has forcefully bolstered: not only does investor protection in this emergent context not countenance increasing opportunities for most retirement investors, it

151. See Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1, 43 (2011) ("Congress' principal intent in enacting the securities laws was investor protection (primarily through mandatory disclosure coupled with anti-fraud rules) . . .").

152. See Thomas Lee Hazen, *Rational Investments, Speculation, or Gambling?—Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets*, 86 NW. U. L. REV. 987, 1027 (1992) ("Regulators must be mindful of the importance of enhancing efficiency by providing for various modes of market participation while simultaneously keeping in mind the goal of individual investor protection."); Michael J. Schmidt, "Investor Protection" in *Europe and the United States: Impacting the Future of Hedge Funds*, 25 WIS. INT'L L.J. 161, 165 (2007) ("As a basic regulatory purpose, investor protections are necessary to effectively . . . encourage market participation.").

153. See *supra* notes 135-140 and accompanying text (discussing how, as Congress envisioned it, investment advice is inherently personal to the person to whom it is provided and should be tailored accordingly).

154. See Jason Zweig, *Do You See Yourself as a Sophisticated Investor?*, WALL ST. J.: MONEYBEAT (July 18, 2014, 12:49 PM), <http://blogs.wsj.com/moneybeat/2014/07/18/do-you-see-yourself-as-a-sophisticated-investor/> (noting that only "sophisticated" investors may participate in private fund offerings).

also widens the gap between those investors and those who already are advantaged in their investment activities, as well as in many other aspects of life. That this damage to retirement investors is wrought by regulation is all the more concerning, given that protecting average-wealth investors is the SEC's signal role¹⁵⁵ and that protective regulation is less important for sophisticated investors, who are deemed capable of fending for themselves.¹⁵⁶ Yet, as the DOL would have it, sophisticated investors will be the only ones remaining to protect.

Finally, the fiduciary rule's effects extend to capital formation, another primary objective of securities regulation. Capital formation is simply the process of increasing the amount of resources that firms can deploy toward producing more and better goods and services, and contributing to economic growth.¹⁵⁷ Yet, one might ask: In an investment arena dominated by passive management, how can capital stock accumulate in an efficient manner when investors no longer attempt to distinguish among the firms that compose global economies? Indeed, not only is active management—that is, investment based on new information about companies and sectors that lowers the prices of overvalued securities and increases the prices of undervalued ones—necessary for furthering the capital formation process, it is also a prerequisite for passive management, which is based on the premise that markets are efficient.¹⁵⁸

155. See Brian G. Cartwright, *Whither the SEC Now?*, 95 VA. L. REV. 1085, 1103 (2009) (“The SEC’s core competence is protection of the retail investor.”).

156. See William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1, 27 (2013) (“In broad terms, the securities regulations deem wealthy or sophisticated investors able to fend for themselves but less wealthy or less sophisticated investors as unable to do so.”).

157. See *Capital Formation*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/capital-formation.asp> (last visited Aug. 29, 2017) (“Capital formation is a term used to describe the net capital accumulation during an accounting period for a particular country, and the term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity.”).

158. See Larry Hatheway, *Remember the Debt Passive Funds Owe Active Managers*, FIN. TIMES (Aug. 9, 2016), <https://www.ft.com/content/6f3ddf50-5a54-11e6-8d05-4eaa66292c32> (observing that “market efficiency . . . requires active management to ensure that any inefficiency is bid away” and that “[p]ure passive investing can . . . be seen as leveraging the work of active managers whose efforts are required to maintain market efficiency”); Tergesen & Zweig, *supra* note 106 (“[I]f fewer managers are drilling into financial reports to pick the best stocks and avoid the worst—index funds buy stocks blindly—that could eventually undermine the market’s capacity to price shares efficiently.”).

IV. EVALUATING AND ADVANCING POLICYMAKING

The DOL has adopted a rule that is within its regulatory mandate but also deep within the SEC's usual regulatory terrain. It did so, moreover, to the detriment of retirement investors, as the previous Part details. Not only does the rule incentivize advisers to funnel retirement investors into passively managed products, it also reflects an exclusionary sentiment that would diminish, rather than increase, these investors' participation in the securities markets. Nevertheless, that the DOL shares considerable, and largely unquestioned, authority with the SEC is not, on its own, problematic—raising the question of why it is problematic in this case.

This Part addresses that question, identifying the causes of the rule's deficiencies and proposing generalizable lessons that can guide future policymaking. Part IV.A uses a doctrinal lens to discern the ways in which the fiduciary rule is inconsistent with the structure of the U.S. securities regulatory regime and to identify the origins of the rule's shortcomings. Addressing the "cause" question from a broader perspective, Part IV.B discusses what the DOL's recent rulemaking tells us about the regulatory silos that dominate U.S. financial regulation—and about achieving effective and efficient regulation even in the context of shared regulatory authority. Finally, this Part suggests how strengthening nonfiduciary advisers' obligations to their employee benefit plan and IRA customers might be accomplished in a less destructive way.

A. The Foundations of U.S. Securities Law

This subpart first contends that, in the system of laws and rules that constitutes U.S. securities regulation, the fiduciary rule is inconsistent with the core foundational principle of the U.S. system of securities regulation—neutrality—and therefore causes dysfunction in that system. Pointing to a second deficiency, the subpart argues that the fiduciary rule also disregards securities regulation's core challenge, which is to manage the harm wrought by conflicts of interest without eliminating conflicts altogether.

1. Maintaining Neutrality

Neutrality—regarding securities, issuers, and risks associated with investing—is the foundation of U.S. securities regulation and the

pivot around which most of its discrete laws and rules revolve.¹⁵⁹ Indeed, neutrality's primacy is rarely questioned, even as the securities laws' specific tools for achieving neutrality frequently are. With the fiduciary rule, however, the DOL has lobbed an alien object into this neutrality based structure, one that replaces the established concept of neutrality about investments with a particular notion of what those investments should be, at least insofar as retirement investors are concerned.¹⁶⁰ That it does so is the basis of the rule's failings.

To appreciate how this is so, consider that over time and in different jurisdictions, securities regulation has assumed different forms. Prior to the enactment of the federal securities laws in the 1930s, securities regulation was the province of the states.¹⁶¹ Most state securities statutes were predicated on the notion that regulators' role was to evaluate the merits of each proposed offering, giving the green light only to those that passed muster.¹⁶² In that context, "passing muster" typically required that the offering price be adjudged "fair" and that other aspects of the offered securities be "just" and "equitable."¹⁶³

159. See Carol B. Swanson, *Corporate Governance: Sliding Seamlessly into the Twenty-First Century*, 21 J. CORP. L. 417, 441 (1996) ("From the very beginning, the securities laws were designed as neutral devices to compel disclosure, avoiding direct interference in the market's judgment about stock value.").

160. See Greg Iacurci, *DOL Fiduciary Rule Pushing Broker-Dealer Assets to Fee-Based Accounts, Away From Commissions*, INVESTMENTNEWS: FIDUCIARY FOCUS (May 24, 2017, 2:43 PM), <http://www.investmentnews.com/article/20170524/FREE/170529958/dol-fiduciary-rule-pushing-broker-dealer-assets-to-fee-based>.

161. See Saul S. Cohen, *The Challenge of Derivatives*, 63 FORDHAM L. REV. 1993, 2025 n.181 (1995) ("By 1929, when the stock market crash precipitated the passage of federal securities laws, all states had some form of securities regulation.").

162. See Ronald J. Colombo, *Merit Regulation Via the Suitability Rules*, 12 J. INT'L BUS. & L. 1, 6 (2013) ("'Merit regulation' is what generally characterized the state regulation of securities at the time of the federal securities laws' promulgation."); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 200 n.238 (2006) ("Merit regulation refers to state regulation that authorizes state securities administrators to approve or deny the offering of securities based on their quality, i.e., whether the offering is fair, just, and equitable.").

163. See Stephen Bainbridge, *Federal Merit Review of Securities Offerings? No Thanks!*, PROFESSORBAINBRIDGE.COM (Apr. 22, 2012), <http://www.professorbainbridge.com/professorbainbridge.com/2012/04/federal-merit-review-of-securities-offerings-no-thanks.html> (quoting Wendy Gerwick Couture, *Price Fraud*, 63 BAYLOR L. REV. 1, 74 (2011)) (discussing the difficulties associated with merit regulation). At the other end of the spectrum, some regulatory bodies have adopted a hands-off approach, whereby any offering not involving fraud was permissible. See *id.* (describing the "fraud model" of securities regulation).

Congress nonetheless took a different approach in its policymaking after the Great Depression, crafting a regulatory structure that obviates the judgment calls that merit regulation requires.¹⁶⁴ More specifically, Congress determined that those standing in certain roles *vis-à-vis* securities transactions (issuers and securities brokers, most notably) must share with their counterparties (investors, typically) relevant information about the securities being bought or sold.¹⁶⁵ The notion was that, armed with such information, investors should be able to make decisions involving the issuer or its securities with open eyes.¹⁶⁶ And because disclosed information must be truthful and not otherwise misleading in order to be effective, Congress coupled the securities laws' robust disclosure requirements with commensurately robust prohibitions on fraud.¹⁶⁷

Congress's preferred route allowed it to avoid the difficulties associated with a merit-focused approach to securities regulation—the dominant one being that merit regulation is paternalistic, predicated on the notion that investors are unable to determine which investments further their interests and which do not.¹⁶⁸ Merit regulation, in other words, assumes that investors will get it wrong and that regulators will get it right. Yet regulation may, in fact, not get it right because, in terms of the substance of what securities issuers do—what services they provide or what goods they produce—regulators have no more insight or understanding than entrepreneurs, economists, customers, or investors.¹⁶⁹ A related problem is that by implicitly requiring that

164. See Colombo, *supra* note 162, at 6 (“[W]hen the United States enacted a regime of federal securities regulation, the road not taken was that of merit regulation.”).

165. See, e.g., Kennedy v. Tallant, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,779, at 90,820 (S.D. Ga. 1976) (observing that “equalization of bargaining positions” is “[a] common thread running through the fabric of the various securities cases”); Anita K. Krug, *Investing and Pretending*, 100 IOWA L. REV. 1559, 1608 (2015) (“[S]ecurities regulation . . . focuses on those with the relative knowledge and, therefore, the relative power [and] seeks to ensure that those with whom those persons transact either have power in their own right . . . or are given access to all relevant information.”).

166. See *What We Do*, *supra* note 43 (explaining that disclosures provide “information about the companies’ financial condition and business practices to help investors make informed investment decisions”).

167. See Michael D. Guttentag, *Protection From What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 209 (2013) (“Mandatory disclosure requirements, in conjunction with antifraud liability, are the primary means by which federal securities regulations are supposed to protect investors.”).

168. See Jeffrey M. Lipshaw, *Dissecting the Two-Handed Lawyer: Thinking Versus Action in Business Lawyering*, 10 BERKELEY BUS. L.J. 231, 247 (2013) (observing that merit regulation is “objectionable for [its] paternalism”).

169. See Gerwick Couture, *supra* note 163, at 76 (“[M]erit review is often criticized for interposing an ill-equipped middleman between issuers and investors.”).

offerings fit regulators' notions of fairness, merit regulation impedes issuers' financing efforts, including by dissuading them from proceeding with their offerings, thereby harming capital formation on a market-wide basis.¹⁷⁰

The fiduciary rule is a form of merit regulation. Although the rule does not require regulatory approval of a securities transaction based on regulators' evaluation of its merits as in the classic understanding of merit regulation, it achieves the same results by virtue of the incentives that it creates—it incentivizes advisers to recommend certain investment products over others and effectively to opt out of securities regulation—and, in the process, pushes investors out of the securities markets.¹⁷¹ However, drawing on the criticisms of merit regulation, the DOL has no more insight than do most retirement investors regarding what types of investments and investment strategies are in those investors' best interests, as Part III suggests. Moreover, it is conceivable that the fiduciary rule's implicit bias could make capital formation less efficient, such as by influencing the nature and extent of the services that advisers provide.

From another, more structural perspective, the rule's infusion of regulatory bias in an environment that otherwise emphasizes neutrality does not work because the bias is limited. That is, in endorsing a particular investment strategy, the DOL did not address how retirement investors should participate in domains outside of its purview—outside of the context of investing retirement assets—in order to counteract the harmful effects of that endorsement. Perhaps (nonretirement) investment opportunities should be expanded for retirement investors, or perhaps all investors should be encouraged to invest some portion of their assets in actively managed products. The DOL did not complete the picture—and, of course, could not complete the picture, given that its mandate does not extend past protecting market participants in their capacities as retirement investors.

170. See *id.* at 77 (“[M]erit review is often maligned for preventing issuers from raising capital by denying them registration.”). A less-pronounced concern with merit regulation is that it produces the prospect of corruption in the regulatory approval process: If regulators have a gatekeeper role in securities offerings, they are also well-positioned to extract rents from would-be issuers. See Robin Hui Huang, *The Regulation of Securities Offerings in China: Reconsidering the Merit Review Element in Light of the Global Financial Crisis*, 41 HONG KONG L.J. 261, 270 (2011) (“[M]erit regulation has . . . provided a fertile breeding ground for rent seeking and corruption by regulators.”).

171. See *supra* notes 151-156 and accompanying text.

2. Muting Conflicts of Interest

We might say that the fiduciary rule causes harm not only because it harbors the deficiencies typically associated with merit regulation but also because the very fact of its inconsistency with neutrality, as the foundational principle of securities regulation, leaves a gap in the securities regulatory framework. Yet there is a second difficulty: The rulemaking is also inconsistent with the way that securities regulation addresses its core challenge, which is to minimize the harm caused by the conflicts of interest that characterize the activities of many securities market participants.¹⁷²

As securities regulation recognizes, those with an advantage in the securities markets are necessarily conflicted, in that they have incentives to use that advantage to further their own financial interests rather than those of their customers, clients, or investors.¹⁷³ For example, a securities issuer has an incentive to “hype” its offerings and performance outlook because doing so will attract investors and possibly increase the price at which it is able to sell its securities.¹⁷⁴ A registered investment adviser has an incentive to “front-run” her clients, such as by buying particular securities and then recommending those same securities to her clients, because doing so will increase the market price of the recommended securities, thereby

172. See, e.g., Jennifer O’Hare, *Synthetic CDOs, Conflicts of Interest, and Securities Fraud*, 48 U. RICH. L. REV. 667, 729 n.413 (2014) (“[T]he federal securities laws . . . permit conflicts of interest to be managed through disclosure in some circumstances.”); Symposium, *The Regulation of Investment Funds*, 16 FORDHAM J. CORP. & FIN. L. 1, 11 (2011) (observing that investment advisers’ compliance officers “serve as the front-line watch for violations of securities laws and provide protection against conflicts of interest”) (comments of Andrew J. Donohue); Peter Talosig III, *Regulation FD—Fairly Disruptive? An Increase in Capital Market Inefficiency*, 9 FORDHAM J. CORP. & FIN. L. 637, 643-44 (2004) (observing that a policy concern behind the SEC’s adoption of Regulation FD was “to minimize conflicts of interests among analysts and the issuers which might seek to curry favor with analysts in return for favorable coverage”).

173. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (“A fundamental purpose [of the securities laws] was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.”); Karmel, *supra* note 31, at 435 (“Conflicts of interest are common in every fiduciary relationship in the financial services industry.”).

174. See BancBoston Robertson Stephens Inc., Comment Letter on Proposed Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934 (Apr. 7, 1999), <https://www.sec.gov/rules/proposed/s73098/benningt1.htm> (observing that “[a]n issuer’s shares may be high priced and actively traded for a variety of reasons” including “false rumors, fraud, arbitrage, ill-informed hype by commentators, etc.” and that “dollar thresholds significantly favor stocks with a high hype level”).

also increasing the adviser's own investment profits.¹⁷⁵ A mutual fund manager has an incentive to cause the fund it manages to pay third parties for marketing services because doing so will increase the fund's assets and, along with them, the amount of (asset-based) fees that the manager receives from the fund.¹⁷⁶

Of course, other legal fields, as well, focus on muting conflicts of interest. After all, to the extent that actors in a regulated area do not behave as they should, it is usually because there is an alternative behavior that they believe better serves their interests. Regulation—and its threat of punishment for those who do not comply—addresses these conflicts by causing it to be in actors' interests to conduct themselves as regulation prescribes.¹⁷⁷ However, conflicts in the securities markets have a different character than they do in other (nonfinancial) domains, due to the fact that in the financial realm, unlike others, any particular conflict is almost immediately reducible to money. Money, in turn, is a more potent motivator than any other source of conflicts, as both financial catastrophes and academic analyses have suggested.¹⁷⁸

Securities regulation further recognizes that the securities markets, like other financial markets, would not (and could not) exist without conflicts. For example, regulation cannot simply prohibit issuers from selling their securities to investors because selling equity

175. See *Capital Gains Research Bureau, Inc.*, 375 U.S. at 181-83, 200-01 (holding that an investment adviser that published a newsletter containing investment recommendations acted inappropriately in recommending various securities to subscribers after having purchased those securities for the adviser's own account, thereby increasing its profit, without disclosing the practice to subscribers).

176. See *Siemers v. Wells Fargo & Co.*, No. C 05-04518 WHA, 2007 WL 760750, at *7 (N.D. Cal. Mar. 9, 2007) (describing how a mutual fund's payment of marketing expenses and the fund's associated growth "inures primarily, if not exclusively, to the benefit of the sponsor and its stake in ever-larger management and advisory fees").

177. See Sarah L. Stafford, *Outsourcing Enforcement: Principles To Guide Self-Policing Regimes*, 32 CARDOZO L. REV. 2293, 2306 (2011) ("[P]otential violators will . . . be deterred by the threat of punishment if the decision to violate is based on rational comparison of the cost of compliance compared to the expected cost of violation.").

178. See George S. Geis, *Shareholder Derivative Litigation and the Preclusion Problem*, 100 VA. L. REV. 261, 308 (2014) ("[A]s is so often the case, one of the best motivators may be money."); Stacy Goto Grant, *International Financial Regulation Through the G20: The Proprietary Trading Case Study*, 45 GEO. J. INT'L L. 1217, 1221-22 (2014) (describing how certain "conflicts of interest are supposed to be restricted by fiduciary relationships, but the desire to make money for the firm's own account creates perverse incentives to violate any fiduciary duties"); Chip Pitts, *Pro-Social Corporate Value(s), Culture, and Purpose Before Profit, in Logic and Law*, 16 U.C. DAVIS BUS. L.J. 69, 86 (2015) ("In general, we place far too much emphasis on extrinsic motivators like money as opposed to intrinsic motivators like values, meaning, pride, and the sense of doing something worthwhile that's bigger than ourselves.").

is an effective way for businesses to obtain financing to grow their operations, and it fosters economic growth.¹⁷⁹ Similarly, regulation cannot prohibit registered investment advisers from buying for their own accounts the securities they recommend to clients because it is desirable (for both investors and the securities markets) for financial professionals to have “skin in the game”—that is, to be subject to the same risks as those to which their clients are subject.¹⁸⁰ Nor, then, can regulation simply prohibit mutual funds from engaging marketers to sell their securities because the additional capital that successful marketing produces, by creating a larger pie, lowers the fees and other costs borne by all of the funds’ investors and therefore also promotes more efficient capital markets.¹⁸¹

These observations mean that, in the financial realm, a different approach to addressing conflicts is warranted. Accordingly, to address the risks that conflicts create, the securities laws and the SEC employ a balancing approach, whereby those who have the advantage in various types of securities transactions may proceed with their activities, subject to defined limits. Issuers may conduct securities offerings but, in so doing, must adhere to stringent limitations on advertising and truthfully disclose material facts about themselves and the offered securities.¹⁸² Registered investment advisers may buy securities that they also recommend to clients but, in so doing, must

179. See Richard A. Mann et al., *Starting from Scratch: A Lawyer's Guide to Representing a Start-Up Company*, 56 ARK. L. REV. 773, 817 (2004) (“Sometimes favorable financing can be obtained through borrowing, although generally selling equity in a company may be the only method available to finance a start-up business.”); Mark Rambler, *Instead of Borrowing, Should My Business Sell Equity?*, CREDIBILITY CAP. (Feb. 5, 2016), <http://www.credibilitycapital.com/news/2016/7/19/instead-of-borrowing-should-my-business-sell-equity-instead> (observing that “[f]or businesses that can effectively attract equity investors, selling equity to fund growth is a good option” because debt can be “can be a major drain on a business”).

180. See Paul Katzeff, *Does Your Mutual Fund Manager Have Skin in the Game? These Do*, INV. BUS. DAILY: MUTUAL FUNDS (Nov. 11, 2016), <http://www.investors.com/etfs-and-funds/mutual-funds/does-your-mutual-fund-manager-have-skin-in-the-game-these-do/> (contending that “[h]aving skin in the game matters” and that “[f]unds with at least one manager who has a lot of their own money invested in the fund are more likely to outperform than funds whose managers have little or none of their cash on the line”).

181. See *What Drives Your Fund Costs Up or Down?*, VANGUARD (June 15, 2016), <https://investornews.vanguard.com/what-drives-your-fund-costs-up-or-down/> (“When [fund] assets grow (whether from market appreciation or cash flow), a fund achieves economies of scale: Fixed costs spread over the larger asset base represent a smaller share of assets.”).

182. See A.C. Pritchard, *Revisiting “Truth in Securities” Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good*, 36 SEATTLE U. L. REV. 999, 1003 (2013) (“[P]ublic offerings are subject not only to extensive disclosure requirements, but also to a byzantine array of gun-jumping rules limiting voluntary disclosure intended to curb speculative frenzies for newly issued securities.”).

make certain that clients are not thereby disadvantaged.¹⁸³ Mutual funds may pay marketers to sell their securities but, in so doing, must ensure that the amounts paid do not exceed specified thresholds.¹⁸⁴

Congress used this approach in its postfinancial crisis legislation—the Dodd-Frank Act—in instructing the SEC to evaluate whether securities brokers who provide investment advice should be subject to fiduciary duties and whether the standards and other rules then applicable to securities brokers were adequate. Specifically, Congress directed the agency, in conducting this evaluation, to consider, among other things, how a heightened standard of conduct might impact retail investors’ access to the products and services that securities brokers offer.¹⁸⁵ Further, it cautioned that, under any rules the SEC might adopt to implement such a standard, neither brokers’ receipt of transaction-based compensation nor their “sale of only proprietary or other limited range of products” could be deemed to violate the standard.¹⁸⁶ Congress thus sought to balance the need to temper problematic conduct by brokers with the need to preserve brokers’ ability to provide their services.

In short, securities regulation perceives that because activities that produce conflicts are desirable for reasons unrelated to the conflicts, regulation cannot simply dissolve the conflicts by prohibiting the associated activities. However, that is what ERISA and the DOL, as its interpreter and enforcer, seek to do. Rather than recognize the nature of conflicts—and their inevitability—in the securities markets, ERISA assumes that it can eliminate them completely, as the statute’s prohibited transaction provisions

183. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963) (“The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients.”).

184. See James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 WASH. U. L.Q. 907, 926 (2005) (“[O]ne percent is the maximum level of distribution costs that Rule 12b-1 permits to be levied against the fund’s assets”); Dana M. Muir, *Revenue Sharing in 401(K) Plans: Employers as Monitors?*, 20 CONN. INS. L.J. 485, 490 (2014) (“In 1980, the [SEC] promulgated Rule 12b-1, which formalized the ability of mutual funds to use fund assets to pay for marketing and distribution costs.”).

185. See Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, Pub. L. No. 111-203, § 913(c)(9), 124 Stat. 1376, 1826 (2010) (codified as amended in scattered sections of 7, 12, 15 U.S.C.).

186. *Id.* § 913(k)(2), 124 Stat. at 1828.

evidence.¹⁸⁷ Indeed, the fallacy of this assumption is arguably the basis of the DOL's principal role—namely, adopting exemptions that permit securities professionals to continue to carry out their business activities *vis-à-vis* retirement assets, notwithstanding the transaction prohibitions under ERISA that would otherwise limit their ability to do so.¹⁸⁸

Yet despite the DOL's historical industriousness in softening ERISA's onerous structures, the agency, in adopting the fiduciary rule, likewise supposed (in error) that it could, and should, eliminate the conflicts to which many advisers are subject without also eliminating these advisers' productive role in counseling retirement investors. By contrast, the SEC, which has also considered strengthening the standard of conduct applicable to brokers in connection with their advisory activities,¹⁸⁹ has at no point countenanced adopting a standard that would ultimately defeat its own purpose.

B. *Regulation in an Era of Shared Authority*

The preceding subpart identifies the doctrinal sources of the fiduciary rule's deficiencies, but there remains another cause, which is this: a rule that will surely have as substantial an effect on the securities markets as any rule adopted in the last few decades was the handiwork not of the SEC but of another regulator, one whose primary function is only marginally related to the securities markets and its participants. These special circumstances warrant searching for the takeaways—that is, lessons that can both guide future policymaking and augment our understanding of the dangers and benefits of shared regulatory authority.

The SEC's sharing of regulatory jurisdiction with another regulator is not unique for regulation generally or for the SEC. Indeed, scholars have devoted considerable energy to cataloging and evaluating the widespread phenomenon of shared—or dual or overlapping—regulatory authority.¹⁹⁰ While some observers contend

187. See *supra* notes 58-66 and accompanying text (discussing ERISA's prohibited transaction provisions).

188. See *supra* notes 67-70 and accompanying text (describing the DOL's role in exempting certain types of transactions from ERISA's prohibited transaction provisions).

189. See *SEC Releases Staff Study Recommending a Uniform Fiduciary Standard of Conduct for Broker-Dealers and Investment Advisers*, U. S. SEC. & EXCHANGE COMMISSION (Jan. 22, 2011), <https://www.sec.gov/news/press/2011/2011-20.htm>.

190. See, e.g., Aagaard, *supra* note 38; Robert B. Ahdieh, *Dialectical Regulation*, 38 CONN. L. REV. 863, 927 (2006); Elizabeth K. Brill, *Privacy and Financial Institutions: Current Developments Concerning the Gramm-Leach-Bliley Act of 1999*, 21 ANN. REV.

that shared authority promotes regulatory efficiency, many others argue that it does the opposite. Perhaps the primary criticisms in this regard are that dual regulation of a particular subject often produces duplicative bodies of rules that are often inconsistent with one another and that the rules, collectively, are confusing, unduly burdensome, and inefficient.¹⁹¹

Unsurprisingly, these criticisms are also the ones directed at shared regulatory authority in the financial arena, which is extensive. In addition to the DOL, the SEC's regulatory mandate overlaps with those of state securities regulators and, at the federal level, the Commodity Futures Trading Commission (CFTC), the Municipal Securities Rulemaking Board, the National Futures Association, and FINRA, among other regulatory authorities.¹⁹² Meanwhile, the Consumer Financial Protection Bureau, the Federal Trade Commission, the Board of Governors of the Federal Reserve System, and many other financial regulatory agencies and bodies likewise share numerous regulatory mandates.¹⁹³

In this siloed regulatory universe and in associated discussions about its ailments, however, another obstacle to effective regulation has generally gone unnoticed: discordant regulatory norms and objectives. In most circumstances, regulators that share authority over a particular subject matter have consonant regulatory goals or priorities. For example, both the Department of Education and the Department of Housing and Human Services have authority to regulate how student health information is used.¹⁹⁴ Although their

BANKING L. 167, 207-08 (2002); Elizabeth Chamblee Burch, *On Regulatory Discord and Procedure*, 11 N.Y.U. J.L. & BUS. 819, 819-20 (2015); Gregory N. Mandel, *Gaps, Inexperience, Inconsistencies, and Overlaps: Crisis in the Regulation of Genetically Modified Plants and Animals*, 45 WM. & MARY L. REV. 2167, 2230-31 (2004); Catherine M. Sharkey, *Agency Coordination in Consumer Protection*, 2013 U. CHI. LEGAL F. 329, 330, 356 (2013); Loren Rensberg, Essay, *Too Many Cooks in the Galley: Overlapping Agency Jurisdiction of Ballast Water Regulation*, 76 GEO. WASH. L. REV. 1412, 1428 (2008).

191. See U.S. GOV'T ACCOUNTABILITY OFF., GAO-08-32, FINANCIAL REGULATION: INDUSTRY TRENDS CONTINUE TO CHALLENGE THE FEDERAL REGULATORY STRUCTURE 1 (2007) (noting in the context of financial regulation that "concerns about inefficient overlaps in responsibility, undue regulatory burden, and possible gaps in oversight raise questions about whether the current structure is best suited to meet the nation's needs").

192. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION: COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 12 (2016) [hereinafter GAO, FRAGMENTED STRUCTURE] (graphically depicting the overlapping authority of U.S. financial regulators).

193. See *id.*

194. See Bryan Thurmond, Recent Development, *Dismantling a Dual-Headed System of Governance: How a Regulatory Overlap Undercuts the Security of Student Health Information in Public Schools*, 64 ADMIN. L. REV. 701, 702-03 (2012) (noting that "[t]wo

approaches to doing so have not always been consistent, the agencies nevertheless share an overarching objective in the student health context, which is to protect students' privacy.¹⁹⁵ On the other hand, the objectives of the Food and Drug Administration (FDA) and the U.S. Department of Agriculture (USDA) in regulating the production of genetically modified plants are different, as the FDA focuses on protecting humans by ensuring food safety,¹⁹⁶ while the USDA focuses on safeguarding and promoting a specific U.S. industry.¹⁹⁷ However, the dual regulatory structure arguably has worked in many contexts in part because the ability of the USDA to further its objectives depends on the FDA's success with its own mission and vice versa.¹⁹⁸ And, returning to the financial context, the CFTC shares authority with the SEC to regulate trading in derivatives and has often employed approaches that differ from the SEC's, even for the same types of instruments.¹⁹⁹ Yet, consistent with the SEC's objectives, the CFTC aims not only to "protect market users and their funds" but also to "foster . . . financially sound markets"²⁰⁰—and historically has done so through mechanisms, such as disclosure

separate statutes . . . govern the privacy of student health information" and that one statute is administered by the Department of Education, while the other is administered by the Department of Health and Human Services).

195. See *id.* at 707-11 (discussing how both strands of regulation aim to ensure the protection and security of student health information).

196. See *What We Do*, U.S. FOOD & DRUG ADMIN., <http://www.fda.gov/AboutFDA/WhatWeDo/> (last updated Apr. 4, 2017) ("The [FDA] is responsible for protecting the public health by ensuring the safety, efficacy, and security of . . . drugs, biological products, and medical devices; and by ensuring the safety of our nation's food supply, cosmetics, and products that emit radiation.").

197. See *About the U.S. Department of Agriculture*, U.S. DEP'T AGRIC., <http://www.usda.gov/our-agency/about-usda> (last visited Aug. 31, 2017) ("[The USDA] ha[s] a vision to provide economic opportunity through innovation, helping rural America to thrive; to promote agriculture production that better nourishes Americans while also helping feed others throughout the world; and to preserve our Nation's natural resources through conservation, restored forests, improved watersheds, and healthy private working lands.").

198. See *Question: What Is More Scrambled than an Egg? Answer: The Federal Food Inspection System: Hearing Before the Subcomm. on the Fed. Workforce & Agency Org. of the H. Comm. on Gov't Reform*, 109th Cong. 38, 51 (2005) (statement of Robert E. Brackett, Director, Center for Food Safety and Applied Nutrition, USDA) (describing "examples of collaboration between FDA and USDA on inspections, enforcement, and training" and noting that "[a]s a result of this effective collaboration, the Federal food safety system is working well").

199. See Dodd-Frank, Pub. L. No. 111-203, § 712, 124 Stat. 1641 (2010) (granting both the SEC and the CFTC authority to regulate swaps); U.S. COMMODITY FUTURES TRADING COMM'N & U.S. SEC. & EXCH. COMM'N, A JOINT REPORT OF THE SEC AND THE CFTC ON HARMONIZATION OF REGULATION 18, 24-26 (2009).

200. *Mission & Responsibilities*, U.S. COMMODITY FUTURES TRADING COMMISSION, <http://www.cftc.gov/about/missionresponsibilities/index.htm> (last visited Aug. 31, 2017).

requirements, that are similar to those on which the SEC primarily relies.²⁰¹

In the case of the SEC and the DOL, however, there is a mismatch, as the previous Part suggests. The securities laws are based on the principle of neutrality, and its specific rules and requirements revolve around taming conflicts of interest without eradicating them.²⁰² Its objectives—protecting investors and promoting capital formation—focus both on the individual and on the broader environment in which she conducts her financial activities. By contrast, ERISA is founded on the principle of achieving optimal conduct by those with control over retirement investors' assets, while its rules and requirements center on requiring specific actions and completely prohibiting others, including any actions that produce conflicts of interest.²⁰³ Although the statute aims to protect investors—or, more accurately, a large category of them—it is not obviously concerned with strengthening the securities markets generally or increasing their productivity. With this comparison, the crux of the matter becomes obvious: the fact that the fiduciary rule fits well within the latter parameters is the source of its dissonance in the former.

Yet this mismatch may be unique, a suggestion that the examples above support, at least anecdotally. And, whether it is the exception that proves the existence of a more generalizable rule—namely, that regulatory overlap exists primarily where the relevant regulators share critical operational characteristics—or a harbinger of similar regulatory failings in the future as society becomes increasingly regulated, it constitutes a new entry in the policymaking primer. Policymakers, in formulating specific regulatory requirements and prohibitions, must become more attuned to the ways in which their work product may intersect with other regulatory mandates. If the regulatory state is already ineffective and counterproductive, as many would argue,²⁰⁴ then it is past time to be more careful about how we

201. See NAT'L FUTURES ASS'N, DISCLOSURE DOCUMENTS: A GUIDE FOR CPOs AND CTAS 1 (Apr. 2015), <https://www.nfa.futures.org/members/member-resources/files/disclosure-document-guide.pdf> (describing disclosure requirements applicable to commodity pool operators and commodity trading advisors).

202. See *supra* Part IV.A, *The Foundations of U.S. Securities Law*.

203. See *supra* Part II.A, *ERISA and the DOL's Rules* (generally outlining ERISA's goals and requirements).

204. See, e.g., GAO, FRAGMENTED STRUCTURE, *supra* note 192, at ii (observing that fragmented regulation has "created inefficiencies in regulatory processes, inconsistencies in how regulators oversee similar types of institutions, and differences in the levels of protection

build upon it. In the present case, in formulating ERISA, Congress could have expressly required that any rules the DOL might adopt pertaining to investment advice or the duties advisers owe to retirement investors be developed with a view toward congruence with established securities regulatory norms and objectives. One hopes, however, that the case at hand will be instructive.

* * *

Achieving the DOL's laudable goal in adopting the fiduciary rule—making the securities markets safer for retirement investors—does not require the particular tools that the DOL chose. Rather, the Department could have followed the SEC's usual approach and interpreted fiduciary duty principles pragmatically. Accordingly, rather than prohibit advisers' traditional practice of receiving per transaction compensation, the DOL could have sought to balance relevant interests—on the one hand, an adviser's interest in conducting business in a manner that allows her to continue operating as an adviser and to recommend to customers whatever investment products she may deem to be in those customers' best interests and, on the other hand, the customers' interests in receiving the best advice available at a reasonable price.

The SEC's positions on registered investment advisers' trade allocation and broker selection procedures provide useful analogies. First, in buying or selling a security on behalf of its clients, an investment adviser may preference some clients over others—even though the transaction is appropriate, in the adviser's judgment, for each of its clients. Such an approach might be warranted if, for example, the adviser wishes to buy a security that is limited in supply.²⁰⁵ Under informal SEC guidance, however, the adviser must implement a rotation or similar system in which every client is

afforded to consumers"); Cass R. Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407, 411 (1990) (observing that “regulation has frequently failed” and that it has “imposed enormously high costs for speculative benefits; sometimes . . . accomplished little or nothing; and sometimes . . . aggravated the very problem it was designed to solve”).

205. See Shane B. Hansen, *Best Execution and Trading Practices: Serving Your Clients While Preparing for Your Regulators*, WARNER NORCROSS & JUDD LLP 12 (Nov. 20, 2013), [https://www.wnj.com/WarnerNorcrossJudd/media/files/uploads/Documents/WNJ-IAA-Workshop-Best-Execution-and-Trading-Practices-\(2013-11-19\).pdf](https://www.wnj.com/WarnerNorcrossJudd/media/files/uploads/Documents/WNJ-IAA-Workshop-Best-Execution-and-Trading-Practices-(2013-11-19).pdf) (“Trade allocation issues often arise in . . . determining which clients will participate in transactions involving initial public offerings or private placements where the supply is limited . . .”).

advantaged in such a transaction no more or less frequently than any other client so that the adviser treats all clients fairly over time.²⁰⁶

Second, in selecting a broker to execute a securities trade on behalf of a client, a registered investment adviser is required to achieve “best execution” and, in determining what is “best,” may consider a range of factors, including brokers’ reliability and financial stability, the size of the transaction, and the market for the security being bought or sold.²⁰⁷ Notably, the adviser may also consider whether a broker has a so-called “soft dollar” arrangement with the adviser, whereby the broker will provide the adviser with research or other services or products (beyond the mere execution of securities transactions) that the adviser may use for her own benefit or for the benefit of clients other than the ones executing the particular transaction.²⁰⁸ Importantly, however, SEC guidance requires that advisers provide robust disclosure to their clients about the advisers’ broker selection policies and procedures and the nature and extent of the advisers’ soft-dollar activities.²⁰⁹

Applied to a reformed fiduciary rule, these approaches might require, for example, that an adviser recommend only those products that she believes to be in the relevant customer’s best interests, defined broadly to include a range of factors. Such factors could include ones pertaining directly to the product, such as the product’s investment approach, the identity of its manager or sponsor, or its historical performance. But they could also include the amount of the (transaction-based) compensation the adviser will receive in

206. *See id.* (“The adviser’s fiduciary obligations have been construed to require, that over time, the adviser ‘fairly and equitably’ allocate investment opportunities among its clients having a similar investment objective.”).

207. *See* Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, 51 Fed. Reg. 16,004, 16,011 (Apr. 30, 1986) [hereinafter SEC Interpretive Release] (opining that “[a] money manager should consider the full range and quality of a broker’s services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager” and that the “determinative factor” in this regard “is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account”).

208. *See id.* at 16,005 (noting that under section 28(e) of the Exchange Act, “money managers [may] consider the provision of research, as well as execution services, in evaluating the cost of brokerage services without violating their fiduciary responsibilities”); 15 U.S.C. § 78bb(e) (2012) (setting forth a safe harbor for fiduciaries who obtain research and brokerage services and products using client commissions).

209. *See* SEC Interpretive Release, *supra* note 207, at 16,007-08 (observing that “[d]isclosure is required even if an arrangement is within the safe harbor provided by section 28(e)” and “adopt[ing] mandatory disclosure standards for advisers involved in such arrangements”).

connection with the transaction, as well as whether that compensation is consistent with the adviser's ability to remain profitable. A further requirement, however, might be that the adviser ensure that the transaction costs that the customer bears, either over time or in comparison to the costs borne by the adviser's other customers, are within a range of costs deemed reasonable by the SEC, working with industry participants.

There are other options for reformulating the fiduciary rule, as one might expect. The point, however, is that any rulemaking that the DOL may undertake that might also be labeled "securities regulation"—and, indeed, any such rulemaking that any other agency other than the SEC may undertake—should take its cue from the way that U.S. securities regulation has been "done" since the early 1930s. This is so not because there is no other or better way to accomplish securities regulatory objectives (this author has argued on many occasions that there are, in fact, better ways) but because the DOL's all-or-nothing approach diminishes the efficacy of the securities regulatory framework that has developed over the past eighty-four years and the relevance of the goals that that framework exists to advance. Any particular rule may further regulatory objectives or may oppose them; however, as this Article suggests, that assessment cannot be made without a view to the rules that surround it and the purpose for which they exist.

V. CONCLUSION

Investors face formidable obstacles in investing effectively—that is, in a manner that furthers their long-term investment objectives. In this regard, navigating the vagaries and volatilities of the financial markets presents only one challenge. Other challenges arise from the process by which investing occurs and the myriad financial professionals—advisers, brokers, plan sponsors—on which it depends. Accordingly, the DOL's adoption of the fiduciary rule, which pushes these professionals to focus exclusively on furthering investors' best interests, has firm grounding in legitimate needs. Based on the Department's intentions alone, the rule is difficult to criticize.

Unfortunately, however, a dissection of the fiduciary rule reveals that it harbors much to criticize. By adopting the rule, the DOL has stepped further into the realm of securities regulation than it ever had previously and has determined—albeit not explicitly—to promote a particular mode of investing over others. In the process, it has also

promoted the exclusion of investors from the financial markets in contravention of securities regulatory objectives and rendered investment advice—and fiduciary duties themselves—irrelevant. Ironically, if there remains an important role for active management in investors' portfolios, then the DOL's requirement that advisers act in their customers' best interests will have produced the result that advisers (by recommending passively managed strategies to the exclusion of actively managed ones) most likely will *not* act in their customer's best interests. That is significant on its own.

Perhaps more significant is that these latent, but worrisome, consequences stem from the DOL's failure to heed the core principle and challenges of U.S. securities regulation. U.S. securities regulation is based on the notion that regulation should be neutral as among the activities that issuers pursue and should harness, without necessarily abolishing, financial professionals' conflicts of interest. Yet with its fiduciary rule, the DOL has effectively forsaken that neutrality and effected a scorched earth strategy against conflicts. We might say, then, that the essential cause of the fiduciary rule's deficiencies is a divergence between two regulators' ends and means. Thus arises this case study's defining lesson: although the factors that produce effective shared regulatory authority are surely elusive—and certainly warrant additional analysis—they necessarily consist of more than admirable intentions and the recognition of unmet needs, however legitimate those needs may be.
