

**Statement of Secretary of the Commonwealth William F. Galvin  
Commonwealth of Massachusetts**

**Middle Class Prosperity Project Forum**

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Rayburn House Office Building, Room 2247**

Senator Warren, Representative Cummings, and distinguished members of the United States Senate and House of Representatives, as chief securities regulator for Massachusetts, I thank you for the opportunity to address the crucial issue of the advice Americans receive when they plan their retirements.

My office, through the Massachusetts Securities Division, has carried out numerous examinations and enforcement actions relating to broker-dealers, investment advisers, and other providers of investment advice in Massachusetts. We have seen first hand the abuses that arise under the current system of providing financial advice to retail investors, particularly with respect to retirement planning.

### **The Fiduciary Standard is Long Overdue**

Our experience makes it clear that *all* providers of retirement financial advice should be held to a fiduciary standard, which will require them to put the customer first. The need for the U.S. Department of Labor's proposed Rule to modernize the ERISA fiduciary rule has been demonstrated. We strongly support the rule proposal.

This reform is a matter of common sense and it is long overdue. The Department of Labor's fiduciary rule under ERISA has not been updated since 1975, so the rule predates current practices relating to retirement saving and planning. In particular, the rule predates the development of IRAs and 401(k) retirement plans, which together now hold the largest portion of retirement assets, estimated at over \$11.5 trillion.

We must build strong legal and financial protections for retirement assets. The traditional sources of retirement security have been sharply eroded. Social Security is significantly underfunded, and we now unfortunately see younger people who are concerned and even skeptical that they will collect meaningful benefits. Moreover, traditional defined benefit pensions have been disappearing for many years. With those changes, it has become necessary for working people to plan and save for their own retirement using vehicles like defined-contribution plans and IRAs.

The task of accumulating a retirement nest egg has been transferred to average citizens. These workers typically have not been trained in retirement planning, so they turn to the financial services industry for products and advice. This has often worked to the detriment of these employees because the great majority of providers of financial products are subject to significant conflicts of interest. And in too many cases, these employees have suffered grievous harm due to abuse and fraud by providers of financial advice.

### **Investor Confusion About Whether Brokers Are Fiduciaries**

A recent S.E.C. Release confirms that many investors are confused or misinformed about whether their brokers are fiduciaries. The brokerage industry fosters this confusion to promote its own interests. Broker-dealers have blurred the standard they operate under

by calling their agents “financial advisers,” which makes the agents sound like an investment adviser rather than stockbrokers.

### **The Costs of Conflicts of Interest in Retirement Advice Have Been Demonstrated**

There is now wide recognition that because most providers of retirement advice are not required to put the interest of customers first, customer funds are often placed in expensive and under-performing financial products.

Because financial advisers are incentivized by commissions and fees, they often do the opposite of putting the customer’s interest first. Many investors are sold high cost, high-commission mutual funds when lower cost options are readily available. Even worse, many brokers sell their retirement investors expensive alternative investment products. These include oil and gas partnerships, real estate partnerships, and non-traded REITs. High commissions and ongoing fees are typical in these so-called alternative investments. Such products drain customers’ retirement savings, rather than providing helpful diversification.

The White House has provided detailed information about the way high costs erode the value of retirement savings over years and decades. Our observations are consistent with theirs: Investors are being harmed by conflicts and high costs in the current retirement savings system.

### **The Impact of Abuse and Fraud on Retirement Savings**

More than 80 percent of financial advisers are not fiduciaries. This can open a door to an array of abusive and even fraudulent practices.

From a legal point of view, stockbrokers are merchants that are subject to standards of fair dealing and suitability. But suitability means only making appropriate investment recommendations to customers. The suitability standard provides investors less protection than might be expected. In practice, the suitability standard allows brokers to sell investments to customers if the sale is justifiable on some ground.

The outcomes for customers under the suitability standard can at times be disastrous, especially when fraud and misconduct are involved.

### **Sales of Speculative Notes by a Major Independent Brokerage**

My office carried out an extensive investigation of sales of speculative investment notes, purportedly backed by medical accounts receivable, by a major independent brokerage. These were unregistered notes sold in non-public offerings –a class of alternative investment. The notes were sold to retail investors, most of them at or close to retirement age, who were looking for a better return than money market accounts or CDs provided. The notes were issued by affiliates of a multi-million financial product company that had inadequate financial controls and unaudited books.

When the several series of these notes collapsed, creating millions in losses for investors, the brokerage did not rush to help make whole the customers to whom it had recommended those offerings. Instead, the firm and its legal team argued that the investors had agreed to purchase these risky and complex investments, and that they were therefore responsible for the consequences when note offerings collapsed.

Our enforcement action resulted in a lengthy administrative hearing. During that hearing investor witnesses, many of them savers rather than investors, who gave consistent accounts of how the notes were offered and sold.

Investors described their relationship with the brokerage and their individual brokers as a relationship built on trust—they expected the brokerage and the agent to make recommendations in their best interests and to look out for them. Investors believed the investment was at least somewhat safe, particularly based on the fact that their broker recommended it. Investors testified that written disclosures, including risk disclosure, were not emphasized at the point of sale (they were treated like ordinary paperwork). They purchased the notes based on their faith in the brokerage and their individual agent.

The brokerage defended itself by discrediting and blaming its customers. At the hearing, lawyers for the broker extensively questioned the investors about the long and technical disclosure materials and multiple subscription documents they had signed. The broker specifically disavowed any notion that it was obliged to act in the best interest of its customers. In fact, the firm turned on its customers by asserting that all of them were responsible for making an unsound investment.

Ultimately, the case was settled through a Consent Order. Under that Order, the brokerage agreed to repay the losses its customers suffered by investing in the notes.

### **Abusive Practices by a Major Brokerage and Its Agent**

My office also carried out an enforcement action against a major national brokerage relating to misconduct by one of their agents. The agent engaged in serious misconduct handling the funds of Boston Edison employees who were given early retirement benefits.

The agent had obtained a list of Boston Edison retirees and aggressively cold called them. His pitch included false promises and guarantees, misrepresenting the safety of investing in the stock market and the amount of returns he could generate. This agent convinced multiple Boston Edison employees to take their retirement distributions as lump sums and roll the money into IRA accounts at the brokerage.

This broker's cold calls created such a disturbance that the CEO of Boston Edison included a note in a statement stuffer to employees warning them against aggressive cold calling by the agent and the brokerage firm.

The agent succeeded in opening sizable accounts at the brokerage with Boston Edison retirees who had rolled over their retirement distributions, which made him a valuable broker at the firm.

This agent engaged in an array of abusive practices with these retirement accounts, including: excessive trading (“churning”); day trading mutual fund shares; placing customers in high-cost money market “B” shares --when a low-cost alternative was readily available; and recommending inappropriate, high risk securities.

The brokerage did not curtail or stop the agent’s misconduct. In fact, the firm ignored or stymied the efforts of supervisory personnel to stop his misconduct.

Only after an investigation and the filing of an enforcement action by the Massachusetts Securities Division did the firm enter into a Consent Order agreeing to repay its customers for the losses they suffered due to agent’s misconduct.

### **IRAs Have Been a Particular Area of Abuse**

Some of the worst cases of abuse that my office has seen are instances where brokers have advised customers to roll over retirement assets into high-cost IRAs. In such cases the investors’ lack of expertise and their need to un-conflicted advice is tragically clear.

We have seen particular abuse in the category of so-called “self directed IRAs.” Self directed IRAs were intended to provide a means for investors to put retirement assets into non-traditional investments within the IRA. We have seen a disturbing trend of sponsors of high-risk investments, as well as fraudsters, recommending that investors concentrate their accounts in exotic and high cost investments. A fiduciary standard could do a lot to clean up this area.

### **Providers of Retirement Advice Must Be Held to a Higher Standard**

The low “suitability” standard that brokers now operate under fails to protect investors, particularly retirement investors, against abuse and fraud. Too often this standard provides brokerage firms with cover for bad practices and high cost products. It also gives brokers a basis to defend cases where customers have alleged bad recommendations, because even an inappropriate recommendation may be justifiable on some ground.

A fiduciary standard will be a significant step to eliminate investor abuse. The problems of fraud and misconduct are not simply the result of bad actors in the industry – unfortunately they will always be with us. A fiduciary standard will increase the vigilance that brokerages must use when they supervise their staffs. Firms will need to upgrade their policies and procedures in order to meet the requirements of the higher standard. This will prevent many instances of fraud and abuse and will help firms to detect it more quickly. Investors will directly benefit when all providers of retirement financial advice are required to be fiduciaries.

I thank you for the opportunity to speak on these issues and I welcome your questions.