The Fiduciary Principle: "No Man Can Serve Two Masters"

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This evening, we meet at a time of financial and economic crisis in our nation and around the globe. *I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that "a man cannot serve two masters." No thinking man can believe that an economy built upon a business foundation can permanently endure without some loyalty to that principle. The separation of ownership from management, the development of the corporate structure so as to vest in small groups control over the resources of great numbers of small and uninformed investors, make imperative a fresh and active devotion to that principle if the modern world of business is to perform its proper function.*

Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their stockholders . . . financial institutions which, in the infinite variety of their operations, consider only last, if at all, the interests of those who funds they command, suggest how far we have ignored the necessary implications of that principle. The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.

Note: The views expressed in this speech do not necessarily reflect the views of Vanguard's present management.

As you may have already figured out, those words (except for the very first sentence) are not mine. Rather they are the words of Harlan Fiske Stone, excerpted from his 1934—yes, 1934—address at the University of Michigan Law School, reprinted in *The Harvard Law Review* later that year. But his words are equally relevant—perhaps even more relevant—on this very day. For they could hardly present a more appropriate analysis of the causes of the present-day collapse of our financial markets and the economic crisis now facing our nation and our world.

You could easily react to Justice Stone's words by falling back on the ancient aphorism, "the more things change, the more they remain the same," and move on to a new subject. But I hope you'll react differently, and share my reaction: In the aftermath of that Great Depression and the stock market crash that accompanied it, we failed to take advantage of the opportunity to demand that our giant businesses and financial organizations—the trustees of so much of our nation's wealth—measure up to the stern and unyielding principles of fiduciary duty described by Justice Stone. So, 75 years later, for heaven's sake, let's not make the same mistake again.

The Columbia Connection

Given this history and this topic, it seems singularly fitting to present this lecture at Columbia University. For Harlan Fiske Stone (1872-1946) ranks among Columbia's most distinguished sons. He received his law degree here in 1898, and returned to serve as dean of Columbia Law School from 1910 to 1923. In 1924, President Calvin Coolidge named Stone as attorney general, and in 1925 appointed him as associate justice of the United States Supreme Court. In 1941, President Roosevelt appointed him as Chief Justice of the United States. When Stone died in 1946, after 21 years of service on the Court, he left a remarkable legacy of career accomplishment, judicial philosophy, and worldly wisdom.*

It seems particularly fitting, then, to discuss Justice Stone's philosophy and his remarkably prescient warning about the abject failure of our corporate and financial institutions that we have witnessed during the recent era, so remarkably similar to their failure some three generations earlier. It is even more fitting to discuss these issues at the annual KPMG Peat Marwick/Stanley R. Klion Forum for 2009, part of Columbia's effort to encourage greater

* A curious coincidence: Justice Stone appeared on the cover of *TIME* magazine on May 6, 1929, just two days before my own birth on May 8. In its profile story, *TIME* accurately speculated that one day Stone would become the chief justice, in part because (in those backward sentences that distinguished the early style of the magazine), "Well he has always tackled the public interest."

awareness of the ethical dilemmas faced by today's business leaders. Included among these leaders are the chiefs who manage our publicly-held corporations—today valued in the stock market at some $10 trillion—and the professional managers of "other people's money" who oversee equity investments valued at some $7 trillion of that total, owning 70 percent of all shares and therefore holding absolute voting control over those corporations. Like their counterparts in business, those powerful managers have not only an *ethical responsibility*, but a *fiduciary duty,* to those whose capital has been entrusted to their care.

Fiduciary Duty

The concept of fiduciary duty has a long history, going back more or less eight centuries under English common law. Fiduciary duty is essentially a legal relationship of confidence or trust between two or more parties, most commonly a *fiduciary* or *trustee* and a *principal* or *beneficiary,* who justifiably reposes confidence, good faith, and reliance in his trustee. The fiduciary acts at all times for the sole benefit and interests of another, with loyalty to those interests. A fiduciary must not put personal interests before that duty, and, importantly, must not be placed in a situation where his fiduciary duty to clients conflicts with a fiduciary duty to any other entity.

Way back in 1928, New York's Chief Justice Benjamin N. Cardozo put it well:

> *Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace . . . As to this there has developed a tradition that is unbending and inveterate . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.*

It has been said, I think accurately, that fiduciary duty is the highest duty known to the law.

It is less ironic than it is tragic that the concept of fiduciary duty seems far *less* imbedded in our society today than it was when Stone and Cardozo expressed their profound convictions. As ought to be obvious to all educated citizens, over the past few decades the balance between ethics and law, on the one hand, and the markets on the other have heavily shifted in favor of the markets. As I have often put it: We have moved from a society in which "*there are some things that one simply does not do*," to one in which *"if everyone else is doing it, I can do it too."* I've described this change as a shift from moral absolutism to moral relativism. Business ethics, it seems to me, has been a major casualty of that shift in our traditional societal values. You will hardly be surprised to learn that I do not regard that change as progress.

At least a few others share this view. In her 2006 book *Trust and Honesty,* Boston University Law School professor Tamar Frankel provides worthy insights on the diminishing role of fiduciary duty in our society. She is concerned—a concern that I suspect that many of you here tonight would share—that American culture has been moving toward dishonesty, deception, and abuse of trust, all of which have come to the fore in the present crisis. What we need, she argues, is "an effective way to increase trust (by) establishing trustworthy institutions and reliable systems," even as she despairs the pressures brought out by the stock market and real estate bubbles that led to "deteriorating public morals . . . and burst into abuse of trust."

In Professor Frankel's view, "we reduced the power of morality in law . . . emasculated the regulation of trusted persons (that is, fiduciaries) . . . abused the laws that govern fiduciaries' honesty . . . and opened the door to enormous losses to the public and the economic system." We also came to ignore the critical distinction between fiduciary law itself and a fiduciary relationship subject to contract law. What's more, she writes, "the movement from professions to businesses was accompanied by changes in the way the law was interpreted." We forgot the fundamental principle expressed by Matthew and Luke, and repeated by Justice Stone: "No man can serve two masters."

My principal objection to moral relativism is that it obfuscates and mitigates the obligations that we owe to society, and shifts the focus to the benefits accruing to the individual. Self-interest, unchecked, is a powerful force, but a force that, if it is to protect the interests of the community of all of our citizens, must ultimately be checked by society. The recent crisis—which has been called "a crisis of *ethic* proportions"—makes it clear how serious that damage can become.

Causes of the Recent Crisis

The causes of that crisis are manifold. Metaphorically speaking, the collapse in our financial system has 1,000 fathers. The cavalier attitude toward risk of our bankers and investment bankers, holding a toxic mix of low-quality securities on enormously leveraged balance sheets. The *lassiez-faire* attitude of our federal regulators, reflected in their faith that "free competitive markets" would protect our society against excesses. The Congress, which rolled back legislative reforms going back to the depression years. "Securitization," in which the traditional link between borrower and lender—under which lenders demanded evidence of the borrowers' ability to meet their financial obligations—was severed. Reckless financial innovation in which literally tens of trillions of dollars of derivative financial instruments (such as credit default swaps) were created, usually carrying stupefying levels of risk and unfathomable levels of complexity.

The radical increase in the power and position of the leaders of corporate America and the leaders of investment America has been a major contributor to these failures. Today's dominant institutional ownership position of 70 percent of the shares of our (largely giant) public corporations compares with only about 8 percent of all corporate shares a half-century ago. This remarkable increase in ownership has placed these managers—largely of mutual funds (holding 25 percent of all shares), pension funds (20 percent), hedge funds, and endowment funds—in a position to exercise great power and influence over corporate America.

But they have failed to exercise their power. In fact, the agents of investment America have failed to honor the responsibilities that they owe to their principals—the last-line individuals who have much of their capital wealth committed to stock ownership, including mutual fund shareowners and pension beneficiaries. The record is clear that, despite their controlling position, most institutions have failed to play an active role in board structure and governance, director elections, executive compensation, stock options, proxy proposals, dividend policy, and so on.

Given their forbearance as corporate citizens, these managers arguably played a major role in allowing the managers of our public corporations to exploit the advantages of their own agency, not only in executive compensation, perquisites, and mergers and acquisitions, but even in accepting the "financial engineering" that has come to permeate corporate financial statements, endorsed—at least tacitly—by their public accountants.

But the failures of our institutional investors go beyond governance issues to the very practice of their trade. These agents have also failed to provide the "due diligence" that our citizen/investors have every reason to expect of the investment professionals to whom they have entrusted their money. How could so many highly-skilled, highly-paid securities analysts and researchers have failed to question the toxic-filled leveraged balance sheets of Citicorp and other leading banks and investment banks and, lest we forget, AIG?* The ethics-skirting sales tactics of CountryWide Financial? Even earlier, what were these professionals thinking when they ignored the shenanigans of "special purpose entities" at Enron and "cooking the books" at WorldCom? Again, going back to the stock market high reached in 2007, how many analysts questioned the typical corporate assumption that their pension plans would earn future returns of 8½ percent per year, now obviously a deeply flawed assumption that is sowing the seeds of another crisis in the financing of our private and public retirement systems.

The Role of Institutional Managers

But the failure of our newly-empowered agents to exercise their responsibilities to ownership is but a part of the problem we face. The field of institutional investment management—the field in which I've now plied my trade for almost 58 years—also played a major, if often overlooked, role. As a group, we veered off-course almost 180 degrees from stewardship to salesmanship, in which our focus turned away from prudent management and toward product marketing. We moved from a focus on long-term investment to a focus on short-term speculation. The driving dream of our advisor/agents was to gather ever-increasing assets under management, the better to build their advisory fees and profits, even as these policies came at the direct expense of the investor/principals whom, under traditional standards of trusteeship and fiduciary duty, they were duty-bound to serve.

Conflicts of interest are pervasive throughout the field of money management, albeit different in each sector. Private pension plans face one set of conflicts (i.e., minimizing plan contributions helps maximize a corporation's earnings). Public pension plans another (i.e., political pressure to invest in pet projects of legislators). And labor union plans yet another (i.e.,

* I'm speaking here of the "buy-side" analysts employed directly by these managers. The conflicts of interest facing "sell-side" analysts were exposed by the investigations of New York Attorney General Spitzer in 2002-2003.

pressure to employ money managers who are willing to "pay to play"). But it is in the mutual fund industry where the conflict between fiduciary duty to fund shareholder/clients often directly conflicts with the business interests of the fund manager.

Perhaps we shouldn't be surprised that our money managers act first in their own behalf. Indeed, as Vice Chancellor Leo E. Strine, Jr., of the Delaware Court of Chancery has observed, "It would be passing strange if . . . professional money managers would, as a class, be less likely to exploit their agency than the managers of the corporations that make products and deliver services." In the fund industry—by far the largest of all financial intermediaries—that failure to serve the interests of fund shareholders has wide ramifications. Ironically, the failure has occurred despite the clear language of the Investment Company Act of 1940 that demands that, "mutual funds should be managed and operated in the best interests of their shareholders, *rather than* in the interests of (their) advisers."[**]

Here, in summary form, are just a few examples of how far so many fund managers have departed from that basic fiduciary principle, clearly enunciated in the 1940 Act:

1. The domination of fund boards by chairmen and chief executives who also serve as senior executives of the management company that controls the funds.
2. The mutual fund "time zone trading" scandals that came to light in 2003, in which some 23 companies—including many of the largest firms in the field—were implicated.
3. "Pay-to-play" distribution agreements using *fund* brokerage commissions ("soft dollars") to finance share distribution that benefits the *adviser*.
4. As fund assets soared during the 1980s and 1990s, fund fees grew even faster, reflecting higher fee rates, as well as the failure of managers to adequately share the enormous economies of scale with fund shareholders.
5. Rising expense ratios for established funds; the average ratio of the seven largest funds of 1960 rose from 0.48 percent to 1.02 percent in 2003, an increase of 144 percent.
6. Managing assets for giant pension funds for fees that are dwarfed by those that they charge the mutual funds that they control. Three of the largest advisers, for example,

[**] Securities and Exchange Commission decision, March 15, 1981.
***2002 data: page 199, *The Battle for the Soul of Capitalism,* by John C. Bogle, Yale University Press, 2005.

charged an average fee rate averaging 0.08 percent to their pension clients and 0.61 percent to their funds, resulting in annual fees averaging $600,000 for the pension funds and $56 *million* for the mutual funds (presumably while holding the same stocks in both portfolios).

7. Spending enormous amounts on advertising—almost a half-billion dollars in the last two years alone—to bring in new fund investors, using money obtained from existing fund shareholders.
8. Creating exotic and untested "products" that have far more ephemeral marketing appeal than investment integrity.

Given such failures as these, doesn't Justice Stone's warning that I cited at the outset seem even *more* prescient? Let me repeat the key phrases: *The separation of ownership from management . . . corporate structures that. . . vest in small groups control over the resources of great numbers of small and uninformed investors . . . corporate officers and directors who award to themselves huge bonuses . . . financial institutions which consider only last, if at all, the interests of those whose funds they command.* Just as we ignored the fiduciary principle all those years ago, so we have clearly continued to ignore it in the recent era. The result in both cases, using Justice Stone's words: *the loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.* Today, as you know, much of that harm can be calculated all too easily, amounting to several trillions of dollars. So, this time 'round, let's pay attention, and demand a return to fiduciary principles.

A Piece of History

While the overwhelming majority of financial institutions operate primarily in the interests of their agents and at the expense of their principals, not quite all do. So I now draw on my personal experiences in the mutual fund industry to give you one example of my own encounter with this issue. As far back as 38 years ago, I expressed profound concern about the nature and structure of the fund industry. Only three years later, my convictions led to action, and 35 years ago this September, I founded a firm designed, to the best of my ability, to honor the principles of fiduciary duty.

I expressed these principles when doing so was distinctly counter to my own self-interest. Speaking to my partners at Wellington in September 1971—1971!—I cited the very same words of Justice Stone with which I opened my remarks this evening. I then added:

> *I endorse that view, and at the same time reveal an ancient prejudice of mine: All things considered, absent a demonstration that the enterprise has substantial capital requirements that cannot be otherwise fulfilled, it is undesirable for professional enterprises to have public stockholders. This constraint is as applicable to money managers as it is to doctors, or lawyers, or accountants, or architects. In their cases, as in ours, it is hard to see what unique contribution public investors bring to the enterprise. They do not, as a rule, add capital; they do not add expertise; they do not contribute to the well-being of our clients. Indeed, it is possible to envision circumstances in which the pressure for earnings and earnings growth engendered by public ownership is antithetical to the responsible operation of a professional organization. Even though the field of money management has elements of both, there are, after all, differences between a business and a profession . . (So we must ask ourselves this question): if it is a burden to our fund and counsel clients to be served by a public enterprise, should this burden exist in perpetuity?*

My candor may well have played a supporting role in my dismissal as chief executive of Wellington Management Company in January 1974. While it's a saga too complex to detail this evening, my firing gave me the chance of a lifetime—the opportunity to create a new fiduciary-focused structure for our funds. I proposed just such a structure to the directors of the Wellington funds.* Wellington Management Company, of course, vigorously opposed my efforts.

Nonetheless, after months of study, the directors of the funds accepted my recommendation that we separate the activities of the funds themselves from their adviser and distributor, so that the funds could operate solely in the interests of our fund shareholders. Our new structure involved the creation of a new firm, The Vanguard Group of Investment

* This lecture at Columbia University is essentially the third part of a trilogy that chronicles the development of the fund industry and of Vanguard itself. The first two parts of the trilogy were my speech at Boston University Law School on January 21, 2004 ("Re-Mutualizing the Mutual Fund Industry—The Alpha and the Omega"); and my speech at George Washington University on February 19, 2008 ("A New Order of Things: Bringing Mutuality to the 'Mutual' Fund").

Companies, owned by the funds, employing their own officers and staff, and operated on an "at-cost" basis, a truly *mutual* mutual fund firm.

While Vanguard began with a limited mandate—to provide only administrative services to the funds—I realized that, if we were to control our own destiny, we would also have to provide both investment advisory and marketing services to our funds. So, almost immediately after Vanguard's operations commenced in May 1975, we began our move to gain substantial control over these two essential functions. By year's end, we had created the world's first index mutual fund, run by Vanguard. Early in 1977, we abandoned the supply-driven broker-dealer distribution system that had been operated by Wellington since 1928, in favor of a buyer-driven "no-load" approach under our own direction. Later that year, we created the first-ever series of defined-maturity bond funds, segmented into short-, intermediate-, and long-term maturities all focused on high investment quality. Then, in 1981, Vanguard assumed responsibility for providing the investment advisory services to our new fixed-income funds as well as our established money market funds. (As you can imagine, none of these moves was without controversy!)

Let me give you some sense of the importance of those changes. Since our formation in 1974, the assets of the Vanguard funds have grown from $1 billion-plus to some $1 trillion today. Some 82 percent of that trillion—$820 billion—is represented by the passively-managed index funds, the bond funds, and the money market funds that we at Vanguard manage, distribute, and advise. Some 25 external investment advisers serve our remaining (actively-managed) funds, with Wellington advising by far the largest portion of those assets. (Most of these funds have multiple advisers, the better to spread the risk of underperformance relative to their peers.).

More than parenthetically, that long string of business decisions was made in a situation in which Vanguard's very existence was in doubt. For the Securities and Exchange Commission had initially refused to approve Vanguard's assumption of marketing and distribution responsibilities. But after a struggle lasting six (interminable!) years, the SEC reversed itself in February 1981. By unanimous vote, the Commission declared that:

> *The Vanguard plan is consistent with the provisions, policies, and purposes of the (Investment Company Act of 1940). It actually furthers the Act's objectives . . . enhances the funds' independence . . . benefits each fund within a reasonable range of fairness . . .*

. . . (provides) substantial savings from advisory fee reductions (and) economies of scale . . . and promotes a healthy and viable mutual fund complex in which each fund can better prosper.

A Prescient SEC?

Indeed. The SEC's words now seem prescient. In fact, "can *best* prosper" would have been more accurate. Measured by Morningstar's peer-based rating system (comparing each of our funds with other funds having distinctly comparable policies and objectives), Vanguard ranked first in performance among the 50 largest fund complexes.*

Advisory fee reductions and economies of scale? Once again, *indeed.* Vanguard's low-costs are legendary, by far the lowest in the field. Last year, over all, our operating expense ratio came to 0.20 percent of average assets, compared to 1.30 percent for the average mutual fund. That 1.1 percentage point saving, applied to one trillion of assets, now gives our shareholders an average savings of $11 billion annually. Do low costs matter? Of course they do! As the world of investing is at last beginning to understand, low costs are the single most reliable indicator of superior fund performance. Yes, as we read in Homer's *The Odyssey,* "fair dealing yields more profit in the end."

If you are willing to accept—based on that solid data—that Vanguard has achieved both *commercial* success (asset growth and market share) and *artistic* success (superior performance and low costs), you must wonder why, after nearly 35 years of existence, *no* other firm has elected to emulate our shareholder-oriented structure. (A particularly ironic outcome, since I chose the name *Vanguard* in part because of its conventional definition as "*leader* in a new trend.") The answer, I think, can be expressed succinctly: under our at-cost structure, all of the darned profits go to the fund shareholders, not to the managers, resolving the transcendent conflict of interest of the mutual fund industry. In any event, the leader, as it were, has yet to find its first follower.

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* John Bogle speech at George Washington University on February 19, 2008 ("A New Order of Things: Bringing Mutuality to the 'Mutual' Fund").

To Build the Financial World Anew

Vanguard represented my best effort to align the interests of fund investors and fund managers under established principles of fiduciary duty. I leave it to wiser—and surely more objective—heads than mine to evaluate whether or not I overstate or hyperbolize what we have accomplished, even as I freely acknowledge that we owe our accomplishments to the three simple principles: the firm is (1) structurally correct (since we are owned by our fund investors); (2) mathematically correct (since it is a tautology that the lower the costs incurred in investing, the higher the returns); and (3) ethically correct (since we exist only by earning far greater trust and loyalty from our shareholders than any of our peers. There's simply no close rival for our #1 position.) Please be appropriately skeptical of that self-serving claim, but look at the data. In a 2007 survey, an independent research group concluded, "Vanguard Group generates far more loyalty than any other company."*

As you have just learned, restructuring the firm was no easy task. Without determination, expertise, luck, timing, and the key roles played by just a handful of individuals, it never could have happened. So when I suggest to this forum that we must now go beyond restructuring the nature and values of a single firm to restructuring the nature and values of the entire money management business, I am well aware of how difficult as task it will be to accomplish that sweeping task.

And yet we dare not stand still. *For we meet at a time when, as never before in the history of the country, our most cherished ideals and traditions are being subjected to searching criticism. The towering edifice of business and industry, which had become the dominating feature of the American social structure, has been shaken to its foundations by forces, the full significance of which we still can see but dimly. What had seemed the impregnable fortress of a boasted civilization has developed unsuspected weaknesses, and in consequence we are now engaged in the altogether wholesome task of critical re-examination of what our hands have reared.*

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* Cogent Research data, as reported in *The Wall Street Journal,* date March 15, 2007. Our loyalty score (percentage of strong *supporters* minus strong *detractors)* was plus 44. The fund industry scored a pathetic *minus* 12.

As you may have suspected, I've once again cited a section of Justice Stone's 1934 speech, and it's high time we take it seriously. For the fact is that there has been a radical change in our investment system from the ownership society of a half-century ago—which is gone, never to return—to our agency society of today—in which our agents have failed to serve their principals—mutual fund shareholders, pension beneficiaries, and long-term investors. Rather the new system has served the agents themselves—our institutional managers. Further, by their forbearance on governance issues, our money managers have also served the managers of corporate America. To make matters even worse, by turning to short-term speculation at the expense of long-term investment, the industry has also damaged the interests of the greater society. Hear Lord Keynes on this point:

> *When enterprise becomes a mere bubble on a whirlpool of speculation, the consequences may be dire . . . when the capital development of a country becomes a by-product of the activities of a casino . . . the job (of capitalism) will be ill-done.*

Yet despite these changes in the very nature of corporate ownership we have failed to change the rules if the game. Indeed, in the financial sector we have rolled back most of the historic rules regulating our securities issuers, our exchanges, and our investment advisers. While we should have been improving regulatory oversight and administering existing regulations with increasing toughness, both have been relaxed, ignoring the new environment and therefore bearing much of the responsibility for today's crisis.

Of course American society is in a constant state of flux. It always has been, and it always will be. I've often pointed out that our nation began as an agricultural economy, then became largely a manufacturing economy, then largely a service economy, and most recently an economy in which the financial services sector had become its dominant element. Such secular changes are not new, but they are always different, so enlightened responses are never easy to come by. Justice Stone, once again, recognized that new forces demand new responses:

> *It was in 1809 when Jefferson wrote: "We are a rural farming people; we have little business and few manufactures among us, and I pray God it will be a long time before we have much of either." Profound changes have come into American life since that sentence was penned. (These) inexorable economic forces, (create) public problems (that) involve an understanding of the new and complex economic forces we have*

created, their relationship to the lives of individuals in widely separated communities engaged in widely differing activities, and the adaptation to those forces of old conceptions developed in a different environment to meet different needs.[*]

To deal with the new and complex economic forces our failed agency society has created, of course we need a new paradigm: a fiduciary society in which the interest of investors come first, and ethical behavior by our business and financial leaders represents the highest value.

Building a Fiduciary Society

While challenges of today are inevitably different from those of the past, the principles are age-old. Consider this warning from Adam Smith way back in the 18th century:

Managers of other people's money [rarely] watch over it with the same anxious vigilance with which . . . they watch over their own . . . they very easily give themselves a dispensation. Negligence and profusion must always prevail.

And so in the recent era, negligence and profusion have prevailed among our money manager/agents, even to the point of an almost complete disregard of their duty and responsibility to their principals. Too few managers seem to display the "anxious vigilance" over other people's money that once defined the conduct of investment professionals.

So what we must do is develop a new *fiduciary* society which guarantees that our last-line owners—those mutual fund shareholders and pension fund beneficiaries whose savings are at stake—their rights as investment principals. These rights must include:

(1) The right to have their money-manager/agents act solely in their behalf. The client, in short, must be king.
(2) The right to rely on due diligence and high professional standards on the part of our money managers and securities analysts who appraise securities for our portfolios.
(3) The right to demand some sort of discipline and integrity in the mutual funds and financial products that they offer.

[*] Again, words from Justice Stone's article.

(4) The assurance that our agents will act as responsible corporate citizens, restoring to their principals the neglected rights of ownership of stocks, and demanding that corporate directors and managers meet their fiduciary duty to their own shareholders.
(5) The establishment of advisory fee structures that meet a "reasonableness" standard based not only on *rates* but *dollar amounts*, and their relationship to the fees and structures available to other clients of the manager.
(6) The elimination of all conflicts of interest that could preclude the achievement of these goals.

More than parenthetically, I should note that this final provision would seem to preclude the ownership of money management firms by financial conglomerates, now the dominant form of organization in the mutual fund industry. Among today's 40 largest fund complexes, only six remain privately-held. The remaining 34 include 13 firms whose shares are held directly by the public, and an astonishing total of 21 fund managers owned or controlled by U.S. and international financial conglomerates—including Goldman Sachs, Bank of America, Deutsche Bank, ING, John Hancock, and Sun Life of Canada. Painful as this separation might be, it is the single most blatant violation of the principle that "no man can serve two masters."

Of course it will take federal government action to foster the creation of this new fiduciary society that I envision. Above all else, it must be unmistakable that government intends, and is capable of enforcing, standards of trusteeship and fiduciary duty under which money managers operate with the *sole* purpose and in the *exclusive* benefit of the interests of their beneficiaries—largely the owners of mutual fund shares and the beneficiaries of our pension plans.

While the government action is essential, however, the new system should be developed in concert with the private investment sector, an Alexander-Hamilton-like sharing of the responsibilities. The task of returning capitalism to its ultimate owners will take time, true enough. But the new reality—increasingly visible with each passing day—is that the concept of fiduciary duty is no longer merely an ideal to be debated. It is a vital necessity to be practiced.

So a lot is at stake in reforming the very nature of our financial system itself, which in turn is designed to force reform in our failed system of governance of our business corporations. What I've passionately advocated in these remarks is hardly widely-shared among my colleagues and peers. But soon, perhaps, many others will ultimately see the light. Only last week the idea of governance reform got encouraging support from Professor Andrew W. Lo of M.I.T., one of today's most respected financial economists:

> *. . . the single most important implication of the financial crisis is about the current state of corporate governance . . . a major wake-up call that we need to change (the rules). There's something fundamentally wrong with current corporate governance structures, (and) the kinds of risks that typical corporations face today.*

In sum, the change in the rules that I advocate—applying a federal standard of fiduciary duty to their clients for institutional money managers—would be designed in turn to force these managers to use their own ownership position to demand that the managers and directors of the corporations in whose shares they invest honor their own fiduciary duty to the holders of their shares. Finally, it is these two groups that share the responsibility for the prudent stewardship over corporate assets and investment securities alike that have been entrusted to their care, not only reforming today's flawed and conflict-ridden model, but developing a new model that, at best, will restore traditional ethical mores.

And so I await—with no great patience!—the return of the standard so beautifully described by Justice Cardozo all those years ago, excerpts from his words cited earlier in my remarks:

> *Those bound by fiduciary ties . . . (are) held to something stricter than the morals of the marketplace . . . a tradition unbending and inveterate . . . not honesty alone but the punctilio of an honor the most sensitive . . . a level of conduct . . . higher than that trodden by the crowd.*

I owe it to Justice Harlan Fiske Stone's legacy to conclude my remarks with yet one more quotation from his profound and prescient 1934 speech that has been the inspiration for my lecture this evening:

> *In seeking solutions for our social and economic maladjustments, we are too ready to place our reliance on what (the policeman's nightstick of) the state may command, rather than on what may be given to it as the free offering of good*

> *citizenship . . . Yet we know that unless the urge to individual advantage has other curbs, and unless the more influential elements in society conduct themselves with a disposition to promote the common good, society cannot function . . . especially a society which has largely measured its rewards in terms of material gains . . . We must (square) our own ethical conceptions with the traditional ethics and ideals of the community at large . (There is) nothing more vital to our own day than that those who act as fiduciaries in the strategic positions of our business civilization, should be held to those standards of scrupulous fidelity which (our) society has the right to demand.*

This Columbia Leadership and Ethics Week of 2009 gives us all the opportunity to strengthen our resolve to meet that test.