PRESERVING RETIREMENT SECURITY AND INVESTMENT CHOICES FOR ALL AMERICANS

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

AND THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

SEPTEMBER 10, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–49

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PRESERVING RETIREMENT SECURITY AND INVESTMENT CHOICES FOR ALL AMERICANS

Thursday, September 10, 2015

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, AND
SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittees met, pursuant to notice, at 10:06 a.m., in room 2128, Rayburn House Office Building, Hon. Sean P. Duffy [chairman of the Oversight and Investigations Subcommittee] presiding.

Members present from the Oversight and Investigations Subcommittee: Representatives Duffy, Fitzpatrick, King, Hurt, Fincher, Mulvaney, Hultgren, Wagner, Tipton, Poliquin, Hill; Green, Cleaver, Ellison, Delaney, Beatty, Heck, and Vargas.

Members present from the Capital Markets and Government Sponsored Enterprises Subcommittee: Representatives Garrett, Hurt, King, Royce, Duffy, Stivers, Fincher, Hultgren, Ross, Wagner, Messer, Schweikert, Poliquin, Hill; Sherman, Meeks, Lynch, Scott, Ellison, Perlmutter, Carney, and Foster.

Ex officio present: Representatives Hensarling and Waters.

Also present: Representatives Barr and Clay.

Chairman DUFFY. The Subcommittee on Oversight and Investigations and the Subcommittee on Capital Markets and Government Sponsored Enterprises will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittees at any time.

Today's hearing is entitled, "Preserving Retirement Security and Investment Choices for All Americans."

I now recognize myself for 1½ minutes to give an opening statement.

The Department of Labor's (DOL's) fiduciary proposal will limit Americans' investment choices. This proposal prescribes an unworkable framework for many lower-income Americans trying to save for their retirement. This is not a Wall Street issue. Millions of Americans in every State will find themselves the victims of this poorly designed regulation.

I believe that Americans, not the government, should be able to make the investment choices that are right for them. Americans al-

ready face a retirement savings crisis, a point even Labor Secretary Perez has acknowledged. Why, then, would he want to make it even harder for Americans to save?

This proposal would result in millions of Americans losing access to their trusted investment advisors as well as their existing retirement accounts, and make it harder for low-balance savers to access retirement products, receive affordable investment advice, and ultimately to do what we want them to do, which is to save.

The rule is supported by the DOL's deeply flawed economic analysis that points to $17 billion in lost income to investors because of fees charged by advisors. Not only does the DOL rely on incomplete, outdated data as a basis for its proposal, it fails to consider the numerous unintended consequences should this proposal move forward.

With so much hanging in the balance, the Obama Administration's sprint for the finish line in this rulemaking puts politics above people and it should be the other way around.

I look forward to our witnesses' testimony today about how this proposal would hurt Main Street investors, first-time savers, and small businesses across the country.

With that, I now recognize the gentleman from New York, Mr. Garrett, the chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises, for 2 minutes.

Chairman GARRETT. Of New Jersey, not New York. Yes, thank you.

Every day, millions of Americans look to a broker-dealer or investment advisor for guidance as to what to do with their hard-earned savings and to help them to have a secure and prosperous retirement.

This was once a privilege only of the wealthy. This personalized investment advice and access to financial markets is now enjoyed by Americans of all income levels.

Back in 2008, the financial crisis and the current market turmoils highlighted the importance of such advice, as numerous studies show that investors who work with a financial professional receive better and more consistent returns on their investment, while those who invest on their own oftentimes make the mistake of buying high and selling low.

In fact, the Department of Labor estimated in 2011 that people who invest without the benefit of professional advice make errors that can cost $114 billion a year. That makes it all the more curious that this same Department of Labor is now marching forward with a regulation that will upend the ability of Americans to receive such guidance and which threatens the retirement security of the most vulnerable within our society.

When President Obama announced the rulemaking earlier this year, a release from the White House stated that the rule, "is taking a step to crack down on those Wall Street brokers who don't put the best interests of workers and middle-class families first."

But if you look at the panel before us, the witnesses today, and in reading through some of the 2,000 comment letters received by the DOL, I think it is pretty clear that the biggest impact of this rule is going to be felt less on Wall Street and more so by the mil-

lions of middle- and lower-income households who may ultimately have no place to go for their advice.

Moreover, the SEC continues to contemplate implementation of a uniform fiduciary standard rule under Section 913 of the Dodd-Frank Act, a rulemaking that remains unsupported by empirical data and which could actually directly conflict with this DOL rule.

So it is clear that the time is now for Congress to act, and by that I would commend Mrs. Wagner of Missouri for her continued leadership on this issue and for, again, putting forth what I think most of us agree is a very thoughtful piece of bipartisan legislation that will help to preserve access to financial advice for Americans of all income levels.

So thank you, Mrs. Wagner.

And again, I thank the witnesses as well, and look forward to your discussion.

I yield back.

Chairman DUFFY. The gentleman from New Jersey yields back.

The Chair now recognizes the ranking member of the Subcommittee on Oversight and Investigations, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

I would like to thank the witnesses for appearing today.

And given that Secretary Perez has been mentioned, I would like to thank him for his work on this rulemaking process and this rule that he is attempting to promulgate. And I do so because I was here when we took on the yield spread premium, and I remember how difficult it was to take action with the yield spread premium, which is not the same as what we are doing today, but which is quite similar with the same effect, the yield spread premium.

And it seems to me that when we know that there are conflicts of interest, some of which are invidious, onerous, some of which are harmful, it would just seem to me that we would want to correct this.

So I commend President Obama for his effort to correct these conflicts and to provide small businesses and people who are trying to retire an opportunity to avoid conflicts of interest that can be harmful.

By way of edification, let me just explain to you how this can work. An investor, a person with a 401(k), pays an advisor some amount of money to assist and advise. The advisor is also paid by a plan or some fund that the advisor recommends to the investor. On its face, probably not a problem.

But when that advisor is incentivized to recommend a fund that may be a high-risk fund, by being paid a higher amount than if the advisor recommended a conservative fund, then you run into possible conflicts that can be harmful to the investor, the person who has a 401(k).

Secretary Perez is making an effort to try to carve out exceptions so that business can continue, but he doesn't want the people who have to depend on advice to be hurt at some point in the distant future because that advice was not given properly. And he talks about the fiduciary relationship, the responsibility of the fiduciary to be loyal, to be a person who takes the interests of the investor

and places that above his personal interests or her personal interests.

Now, with reference to the $17 billion, it appears that this is from 2013; 2013 is not that long ago in my world, and $17 billion is not a small amount of money. We talk quite regularly about how we have decided that billions don't equate to large losses, but I am not in that club. I think that a $17 billion loss is quite a bit of money. And my hope is that we will be able to remedy this circumstance.

Another point: Dr. King talked about the "paralysis of analysis," how we can literally take an issue and analyze it to the extent that we get nothing done.

This is a different version of the paralysis of analysis, the bill that we will be reviewing, because the bill would require that DOL not act until the SEC has acted. My contention is if you want the SEC to act, allow the DOL to move forward, and as a result of moving forward that will encourage action by the SEC.

I am absolutely convinced that what we are trying to do is appropriate in terms of rulemaking.

And Mr. Bullard, I have read your testimony in its entirety, and I want you to know that I compliment you on the statements that you have made. You have given us a clear picture of what happens when we have these conflicts of interest, that some people call kickbacks by the way. They are known by a good many people as kickbacks, these conflicts of interest.

In one of your statements on page 14 of what I have as your report, you indicate that it is economically irrational for the advisor to be paid more to recommend an aggressive asset allocation over a conservative one. I think that is a pretty strong statement, and I commend you for making the statement.

Your statement in its entirety is one that I enjoyed reading, and I commend you for the strong stance that you have taken.

Thank you, Mr. Chairman. I am going to yield back my time, but I will not yield on the question of making sure that we protect small investors.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, the sponsor of H.R. 1090, the Retail Investor Protection Act, for 1½ minutes.

Mrs. WAGNER. Thank you very much, Mr. Chairman.

And thank you all for joining us today to discuss this very important issue that could potentially jeopardize the access of millions—millions—of low- and middle-income Americans to receiving investment advice for their retirement.

Make no mistake. The chairman mentioned a bit ago that America is in a retirement savings crisis today. Washington needs to be empowering individuals to save for retirement, not making it more difficult. This has been one of the most significant issues I have taken up since coming to Congress in 2013.

My legislation, the Retail Investor Protection Act, will help prevent Washington from interfering with the ability to save for retirement.

I want to thank the Members across the aisle over the years who have made this a bipartisan issue. We had 30 Democrats vote for

this legislation in the last Congress, many of whom sit on this very committee, and this year we have seen 12 Senate Democrats write letters outlining major concerns about the Rule.

I was also pleased to have Representative David Scott and Lacy Clay join with Representative Andy Barr and so many others on a letter to the Department of Labor at the end of July asking for a re-proposal

I look forward to working with even more Members from across the aisle, starting with this hearing today.

I know many of us heard from our constituents over the August recess, and I hope that everyone asks the right questions that will help protect access to financial advice for those back home.

I thank you, and I yield back my time.

Chairman DUFFY. The gentlelady yields back.

I again want to welcome our panel, our witnesses today.

By way of brief introduction, we have Caleb Callahan, senior vice president and chief marketing officer at ValMark Securities; Paul Schott Stevens, president and CEO of the Investment Company Institute; Professor Mercer Bullard, MDLSA distinguished lecturer and professor of law, University of Mississippi Law School; Mr. Scott Stolz, the senior vice president, PCG Investment Products, Raymond James & Associates; and we also have last but not least Juli McNeely, president of the National Association of Insurance and Financial Advisors—she is also from the great State of Wisconsin, a small town, has a great Member of Congress representing her in the committee and in the House.

I am not biased.

I just want to remind our witnesses that you do have three lights in front of you. You are going to be recognized for 5 minutes. The green light means go, the yellow light means you have a minute left in your testimony, and the red light means your time is up.

So with that, Mr. Callahan, you are recognized for 5 minutes.

STATEMENT OF CALEB CALLAHAN, SENIOR VICE PRESIDENT AND CHIEF MARKETING OFFICER, VALMARK SECURITIES, INC., ON BEHALF OF THE ASSOCIATION FOR ADVANCED LIFE UNDERWRITING (AALU)

Mr. CALLAHAN. Chairmen, Ranking Members, and members of the subcommittees, thank you for the opportunity to testify today. My name is Caleb Callahan, and I am a principal of ValMark Securities. I am testifying today as a member of the AALU and on behalf of the 2,200 life insurance professionals it serves nationwide.

Our firm has roughly $14 billion in assets under care. These assets are split evenly between the fee-based regime and the brokerage regime. This is relevant because we build numerous financial plans which call for solutions from both of these models as being regularly needed and regularly used.

My purpose today is to provide feedback on the Department of Labor's rule based on real-world experience, working directly with advisors and clients.

I also want to convey that while well-intended, this rule will likely have the very opposite effect that it intends to have on savers.

And finally, I want to express my strong support for Representative Wagner's Retail Investor Protection Act. This is a thoughtful

piece of legislation that will lead to better rulemaking and avoid the unintended consequences which include average savers losing choice and access to professional advice.

The first main point I want to make is that the Department of Labor chose not to build on the existing regulatory framework. Members of this committee are well aware that the SEC has long-tenured experience with standard-of-care issues. And FINRA itself commented in its own letter to the Department that this proposal does not reflect marketplace realities and will lead to a "fractured approach" in the market.

But most importantly, the Department did not build on its own great work. Recently, it finalized final 408(b)(2) disclosure regulations. These regulations require advisors to disclose the services they provide, whether or not these services are provided in a fiduciary capacity, and the fees associated with those services.

I can tell you in analyzing our own business data, the commission-based brokerage plans under this disclosure regime grew by a rate of 26 percent where the fee-based regime grew by a rate of 114 percent, nearly 4 times that.

And in talking with advisors, they say that these metrics are directly the result of these final disclosure rules. So the bottom line is the data shows a movement towards fee-based plans, and yet there is a need to preserve the choice for access to commission-based plans.

And so the question is, why would we not build on this new and great work rather than forge into uncharted waters with this regime?

The second point is that the proposal conflicts with other key regulatory initiatives. A recent GAO study talked about the importance of savers analyzing whether or not they should delay Social Security. And I will just simply say that analysis is not general, it is not hypothetical; it is very unique. And the Department's proposal makes that advice less available in the market.

In addition, for the last several years the Treasury has promoted the use of lifetime income annuities, but the DOL proposal will discourage the use of these important tools.

And finally, the Department of Labor has not coordinated how expanding its own fiduciary standard into the space of IRAs, which already has a fiduciary standard under the SEC, will be harmonized.

For example, the SEC has indicated that the fee-only regime is not always the best regime in all circumstances.

The third and final point I want to make is that this rule will harm average savers. Small investors will lose access. And people want to politicize this point and question whether or not it is real; I am telling you, it will happen.

In this, we are dealing with people, not just statistics. I was reminded of this: My mother called me a couple of weeks ago. Now, my mom's an incredible lady, but she has not saved much money. She has done a lot of volunteer work most of her life. Her and my dad have saved about $25,000.

She asked me a series of questions, should I file Social Security? Should we file and suspend? And I was able to walk her through a number of scenarios.

The point is that for 1 percent of $25,000, $250, with this rule professionals will not provide advice with unlimited liability. And my parents and people like them will lose access to the advice that they need.

My final point is that consumers will lose choice. And consumers have the right to make informed choices, and we must protect this right.

Here is a critical point: Other markets have shown us that clear and simple tools like standardized disclosures, good-faith estimates, and consumer reports can empower customers to make informed decisions. So I challenge the committee to help us preserve the right for retirement savers to make choices that are in their best interest, but as they determine that best interest to be.

I want to thank the committee for the opportunity to testify this morning. And at the appropriate time, I welcome any questions on my oral or written remarks.

Thank you.

[The prepared statement of Mr. Callahan can be found on page 95 of the appendix.]

Chairman DUFFY. Thank you, Mr. Callahan.

Mr. Stevens, you are recognized for 5 minutes.

STATEMENT OF PAUL SCHOTT STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, INVESTMENT COMPANY INSTITUTE (ICI)

Mr. STEVENS. Thank you, Chairman Duffy, Chairman Garrett, Ranking Member Green, and members of the subcommittees. I am grateful for the opportunity to discuss the Department of Labor's proposed new definition of fiduciary duty for retirement advice and services.

ICI and its members strongly support the principle that underlies the Department's proposal. All financial advisors should be held to act in the best interests of their clients.

The proposal itself, however, is deeply flawed.

Were the rule adopted in anything like its current form, it would harm retirement savers by drastically limiting their ability to obtain the guidance, products, and services they need to meet their retirement goals. It also would increase costs, particularly for those retirement savers least able to afford them.

You have my very detailed written testimony. And in this statement, I would just like to make four points.

First, supporters of the proposal claim that retirement savers are suffering $17 billion a year in harm due to broker-provided advice. This claim is false. It is an exercise in storytelling.

The claim relies on academic studies using outdated statistics that simply don't reflect today's fund marketplace. And the Department of Labor relying upon these studies, not doing its own analysis, then misapplies the studies actually to overstate their findings.

The Department also assumes that broker-sold funds are underperforming other funds and thereby harming investors. In fact, a simple review of publicly available data shows that investors who own front-end-load funds have concentrated their investment dollars in funds that outperform, not under-perform, the Morningstar

category that they are part of by about one-quarter of 1 percent each year.

Second, the Department ignores the significant social harm that its proposed rule would cause. Its economic analysis takes no account, for example, of the costs the rule would impose on investors by forcing them to move from commission-based advice to fee-based accounts. We calculate that the higher costs of these fee-based accounts will total $47 billion over the rule's first 10 years.

The Department also ignores the harm that investors with small accounts will suffer when they lose access to advice.

Fee-based advisors typically require minimum balances of $100,000 or more. But three-quarters of individual retirement accounts hold less than $100,000. In fact, half hold less than $25,000. That is 20 million savers.

Chairman Garrett, I asked my research team how many would that mean in New Jersey? We estimate about 120,000 people in your State are in that category.

We estimate that bad decisions by investors as a result, who can't obtain the advice that they need, will reduce their returns by $62 billion over the rule's first 10 years.

The analysis that we have done, and it is spread out on the record for all to see, indicates that far from reducing costs, the rule would increase fees and lower returns, resulting in $109 billion in increased costs to American workers over 10 years.

To make matters worse, rather than grandfathering existing relationships, the rule would compel many investors to pay twice for the same advice and services by incurring fees to manage assets on which they have already paid commissions.

Such a massive overhaul of the marketplace for retirement investment advice should be supported by a solid analysis that clearly identifies a substantial problem and convincingly demonstrates that there are no easier or better remedies available. By this standard, the Department's justification fails utterly.

My third point is the Department's overly expansive and ambiguous fiduciary definition will impede commonplace interactions that retirement savers now take for granted.

In my written statement, I describe my adult son's recent experience consulting with the call center of a major mutual fund company about rolling over his 401(k) balance to an IRA. Following the adoption of the proposal, I believe it is highly unlikely that fund providers will be able or willing to provide the kind of help or information that he received and that is most needed by young people starting into their working lives, people of limited financial expertise, and those with modest retirement savings balances.

Fourth, the best-interest-contract exception will not mitigate the harm caused by this expansive and ambiguous fiduciary definition. It is laden with burdensome contract requirements, an array of compliance and liability traps. In fact, it is quite useless.

What is certain is that financial firms are unlikely to subject themselves to the BIC exemption strictures and our members have told us that they will not.

As you will see in my written statement, we have offered the Department detailed suggestions about how to repair the proposal. We share with this committee and the authors of H.R. 1090 the

goal of getting this goal right. And if the Department continues on its current course, it will get the rule disastrously wrong.

Thank you very much.

[The prepared statement of Mr. Stevens can be found on page 241 of the appendix.]

Chairman DUFFY. Mr. Bullard, you are recognized for 5 minutes.

STATEMENT OF MERCER E. BULLARD, MDLA DISTINGUISHED LECTURER AND PROFESSOR OF LAW, UNIVERSITY OF MISSISSIPPI SCHOOL OF LAW

Mr. BULLARD. Thank you. Chairman Duffy, Chairman Garrett, Ranking Member Green, and members of the subcommittees, it is an honor and a privilege to appear before you today. Thank you for this opportunity.

And I especially appreciate Ranking Member Green's astute reading of congressional written testimony.

I am the founder and president of Fund Democracy, a nonprofit advocacy group for investors, and a professor of law at the University of Mississippi's School of Law.

I will briefly discuss H.R. 1090 and then discuss the Department's fiduciary rulemaking.

Section two of H.R. 1090 would require that the Department delay rulemaking until the commission has adopted fiduciary rules. In my view, the Department's rulemaking is long overdue and any further delay will continue to allow broker-dealers to provide improper financial incentives to financial advisors, making the Department's rulemaking contingent on SEC actions particularly inappropriate.

One reason is that the legal standards that the Department and the SEC apply are quite different. Financial advisors' standards of conduct are lower than the standards applied under securities laws and the standards applied under ERISA.

Another reason is that their jurisdiction is different. The Department has jurisdiction over all retirement assets, including non-securities, whereas the SEC has jurisdiction only over securities.

In my view, Section 3's requirement for further SEC study and findings as a condition of rulemaking is also inappropriate. Such requirements create unnecessary and redundant regulatory burdens and undermine notice and comment process under the APA while not creating any material benefits.

There are two facts about the Department's proposal that I suggest the subcommittees consider foremost. First, financial advisors have significant incentives to make recommendations in order to maximize their own compensation. Second, industry claims that the proposal is not workable are not based on how the proposal would actually work.

The adverse effect of conflicted compensation is undeniable. If you pay more for an activity, you will get more of it. Financial advisors are paid more for recommending stock funds than for bond funds and short-term bond funds. As a result, more stock funds are sold than short-term bond funds.

To put some numbers on the conflict of interest, a stock fund would typically charge a 5¾ percent commission, of which 5 percent would go to a broker-dealer, and the broker-dealer would then

typically pay about 2 percent to the financial advisor. So that would be about $200 to the financial advisor for a $10,000 investment.

If the financial advisor recommended a much safer, short-term bond fund, the advisor would be $80. The advisor would be paid more than twice as much for recommending a risky stock fund over a safe, short-term bond fund.

Advisors selling incentives can actually be far more distorted. For example, broker-dealers often pay advisors a substantial bonus if they reach a certain level in commissions, say $300,000. On the first $299,000 they would be paid 30 percent, but if they reached $300,000, they might be paid 40 percent. In other words, one small $10,000 investment can result in additional payment of $29,000.

The advisor might recommend a short-term bond fund and be paid only $80 or a stock fund that gets them the $300,000 in commissions and be paid more than $29,000—$80 or $29,000?

It would be helpful to know if my fellow panelists think it is appropriate to be paid twice as much for selling a stock fund than a short-term bond fund, or whether it is appropriate to choose between a recommendation that would pay you $80 than $29,000.

My understanding is that Raymond James does not pay retroactive commissions. Why did Raymond James make that decision? Or more importantly, does Raymond James find its own policy to be unworkable, that avoids the conflicts of interest that are created by retroactive commissions?

The Department's rulemaking is eminently workable. The proposal would affect compensation paid only at the advisor level, not at the broker-dealer level. Even then, it would not affect higher compensation paid to advisors, for example, for selling variable annuities. Advisors could be paid more for selling platform funds.

The industry claims the proposal would prohibit commissions. There is nothing in the proposal that prohibits the payment of commissions.

The industry claims that small investors will be harmed by the proposal. They are correct that the Department's rulemaking will affect small investors differently. It will provide greater benefits to them than to any other group. Conflicted compensation harms small investors more than any other group of investors. Small investors are paying the highest price for indefensible compensation practices that I have already described.

Thank you again for the opportunity to appear. I would be happy to answer any questions.

[The prepared statement of Mr. Bullard can be found on page 66 of the appendix.]

Chairman DUFFY. Thank you, Mr. Bullard.

Ms. McNeely, you are recognized for 5 minutes.

STATEMENT OF JULI MCNEELY, PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS (NAIFA)

Ms. MCNEELY. Thank you, Chairmen Duffy and Garrett, Ranking Members Green and Maloney, and members of the subcommittees.

I am Juli McNeely, NAIFA president, and owner of McNeely Financial Services in Spencer, Wisconsin.

NAIFA members like me are in every congressional district in this country. I personally have 25 small-business clients, most with fewer than 25 employees, and 484 individual clients with an average account size of approximately $71,000.

Most of my clients started out as new savers and most likely would not have started a systematic retirement savings without my encouragement and advice.

The DOL proposal is well-intended, but unless substantially changed, it will hurt middle-income savers. People of modest means either cannot afford or are not comfortable with fee-for-service advice.

I compared the costs of commissions versus asset management fees for a small retirement saver and found the saver would pay twice as much over a 20-year period for an asset-based service arrangement. If left with less choice and less advice, fewer will take the steps needed to put in place a long-range plan to fund their retirement. They need more, not less, advice on whether and how to save for the long term.

The best-interest-contract exemption, which almost all NAIFA members will need to use to provide fiduciary advice to middle-income clients, not only adds significant implementation costs, but it also will add costs due to considerable increase in the risk of litigation.

The DOL minimizes the likelihood for lawsuits based on poor investment performance, but there will be more lawsuits. And while many will be resolved in favor of the advisor who behaved appropriately, the cost of defending and insuring against that risk will be substantial.

The BIC exemption creates a barrier by requiring a signed contract acknowledging fiduciary responsibility both by the advisor and all financial institutions offering products before the advisor makes any recommendations. The cost to explain it to a client with whom the advisor is still building trust is likely to be prohibitive.

The DOL proposal is complex and requires the creation and implementation of an entirely new compliance regime. There will be massive market disruption and many middle-income retirement savers will suffer without advice on their retirement planning decisions.

Additional complexity will also adversely impact the use of annuities. Different sets of rules will govern fixed and indexed as compared to variable annuities.

Annuities, with their lifetime income guarantees and ability to manage longevity risks, are the retirement planning vehicle of choice for many middle-income savers. Unlike their wealthier counterparts who can afford and are comfortable with fee-for-service investment accounts, middle-income savers cannot use their modest account balances to self-annuitize. They need the guarantees provided by annuities.

And the DOL proposal governing annuities makes it more difficult and, for some, impossible to give advice on annuities.

Many NAIFA members are agents or affiliates of insurance companies who primarily offer their own products or may have limitations on sales of other companies' products. The DOL must make clear that advisors who offer annuities and/or proprietary products

do meet the impartial conduct and best-interest requirement of the rule.

NAIFA supports H.R. 1090, which would prevent the DOL from writing new rules to govern retirement saving vehicles until after the SEC has studied and reported to Congress whether the imposition of new duties and obligations is advisable and until the SEC has the opportunity to issue any such rules.

It is imperative that the rules governing investment products and advice in the retirement space, including IRAs, not conflict with the rules that govern the same products outside the realm of retirement savings. Only the SEC can issue rules that would impose a uniform standard in both contexts.

Secretary Perez has repeatedly noted how helpful stakeholder input has been to date. The DOL agrees extensive changes need to be made. And to be sure that any such changes will be workable in the real marketplace, it is critical that we have an opportunity to comment on the revisions, and for the Department to incorporate that feedback into final rules if it proceeds.

Thank you.

[The prepared statement of Ms. McNeely can be found on page 103 of the appendix.]

Chairman DUFFY. Thank you, Ms. MeNeely. The Chair now recognizes Mr. Stolz for 5 minutes.

STATEMENT OF SCOTT STOLZ, SENIOR VICE PRESIDENT, PCG INVESTMENT PRODUCTS, RAYMOND JAMES & ASSOCIATES, INC.

Mr. STOLZ. Thank you, Chairman Duffy, Chairman Garrett, and members of the subcommittees for giving me the opportunity to testify here today.

I am Scott Stolz, senior vice president for Private Client Investment Group for Raymond James.

On behalf of the 6,500 advisors and 10,000 employees who work hard every day to take care of the financial needs of our 1 million clients, I want to express our appreciation for giving me the opportunity to share our thoughts on this very important topic.

From our home base in St. Petersburg, Florida, Raymond James has grown to a national firm based mainly on a retail business model that serves the individual investors. Our firm's core principle is service first. We believe that if you take care of the client, everything else will take care of itself.

This emphasis on taking care of the client, along with our focus on long-term results as opposed to the next quarterly earnings cycle, has served us very well.

Now, most of those in favor of the Department of Labor's proposal want to frame this debate solely on whether or not a financial advisor should put their clients' best interests first. After all, who could possibly argue with that?

But this debate is really about the road we take to get there. Once one fully understands the hundreds of pages of proposal the Department has put forth to achieve this mutually agreed-upon goal, there is only one possible conclusion, which is that the rule, as written, is overly complex, would be incredibly expensive to im-

plement, and would expose the hundreds of thousands of trusted and well-meaning financial advisors to unfair legal liability.

On more than one occasion, Secretary Perez has cited the case of the Toffels as an example of why this rule is necessary. The Toffels had accumulated much of their savings in Vanguard mutual funds. Their bank recommended they cash out their mutual funds and purchase what the Secretary has called a very complex variable annuity with $650,000 of the proceeds.

This recommendation has been criticized for being too costly. According to Secretary Perez, this conflicted advice most certainly caused the advisor to put his interests before that of the Toffels.

Whether or not the advice the Toffels received was in their best interests is open to debate. But what I do know is the Toffels case can actually be used as an example of the flaws of the current proposal.

Subsequent to the recommendation the Toffels received, Mr. Toffels' health unexpectedly deteriorated. Not surprisingly, financial flexibility became their biggest financial need. It seems obvious to me that the annuity recommendation didn't work out, not because it wasn't in the Toffels' best interest, but because their circumstances significantly changed.

Yet here we are not only second-guessing the recommendation, but condemning it and labeling it a tragic story, to use the Secretary's words.

And this is exactly what will play out time and time again if the DOL proposal is adopted as is. The complexity, ambiguity, and legal requirements of the rule will ensure that well-meaning advisors who work hard to put their clients' best interests first will be subject to Monday-morning quarterbacking.

Faced with this potential, advisors will make investment recommendations based in part on how they can best limit their potential future liability. It is inevitable, therefore, that they will move to a one-size-fits-all pricing model so they can avoid any possibility of being accused of making a recommendation based on how they were compensated.

Under such a model, many will either pay more than they do today or will get no advice at all. This is particularly true for the smaller investors, the very ones the Department of Labor is trying to protect.

Current security laws and regulatory practices protect advisors from unwarranted Monday-morning quarterbacking to some degree. Unfortunately, the Department's proposal will strip these protections and open a Pandora's box of litigation based on investment outcomes that can never be predicted with certainty by even the best-intentioned advisor.

We stand ready to continue to work with the Department of Labor to craft a final rule, and we believe that if the Department adopts the changes we have outlined in our comment letter, they can accomplish this goal with minimal disruption to the financial system.

However, since they have indicated that there will not be a reproposed rule, we are understandably concerned that the final rule will be no more workable than the current one.

In addition, we believe that the SEC's deep industry knowledge puts them in a much better position to craft a workable rule. And for these reasons, we support the Wagner bill.

In closing, I want to emphasize that Raymond James has long been a supporter of a common fiduciary standard. Long before the Department of Labor first proposed a rule, we instituted a client bill of rights that is given to every client when they become a client of Raymond James. Amongst these rights is the right to expect recommendations based solely upon the client's unique needs and goals, as well as the right to know all costs and commissions associated with a recommendation.

We just don't think it takes a hundreds-of-pages proposal in order to accomplish this goal.

I would like to thank the committee for this time. And I would be happy to answer any questions you may have.

[The prepared statement of Mr. Stolz can be found on page 267 of the appendix.]

Chairman DUFFY. Thank you, Mr. Stolz.

The Chair now recognizes himself for 5 minutes for questions.

Listen, I think we are all on the same page. We want to make sure that Americans are incentivized to save for their retirements, and we want to make sure they get good advice, that they invest well, and that they are able to pick products and services that best meet their needs.

I have to tell you, I have been in this town for 4½ years, and bureaucrats who sit in really fine offices and buildings don't always know what is best or what families consider best in Spencer, Wisconsin; or Wausau, Wisconsin; or Hayward, Wisconsin.

And I think to have the opportunity to get good advice should be made by the individual investor.

We have heard claims, not to bring up "Obamacare" but I will, that if you like your doctor you can keep your doctor, if you like your health insurance plan, you can keep your health insurance plan; and so, too, if you like your financial advisor and your financial plans, you can keep those as well after this rule.

Both of them, all of them are wrong.

What concerns me the most with the way this rule is crafted is that if you are wealthy, if you have a fat account, you are going to get great advice, you are going to be the one who can find professional help in how you invest to get the best return on your investment.

But if you are a lower-income or smaller saver, this rule isn't going to allow you to get professional advice. You are going to be now relegated to robo-advisors. I am stuck with my computer, putting in random data and letting the computer print out what the computer through algorithms thinks is best for me?

Ms. McNeely, in the last month you have see the markets swing, like the rest of us have. By chance, did you get more calls in the last month than you have in previous months?

Ms. MCNEELY. Generally, I do. However, I have found that if I do proper planning with my clients, we have protected them from that downside with the use of annuities. But yes, absolutely, when the market fluctuates they call me, we talk through it, we calm them down, and they move forward.

Chairman DUFFY. When people see a large downturn in the market, do they sometimes become afraid and want to sell?

Ms. MCNEELY. Without question.

Chairman DUFFY. And do you think that is the best thing for your clients to do?

Ms. MCNEELY. It is the exact wrong time to be selling, sir.

Chairman DUFFY. And you are able to counsel them through that, right?

Ms. MCNEELY. I actually call it, "telling them not to jump off the bridge." So yes, we do counsel them through it.

Chairman DUFFY. I would have to argue that talking to a financial advisor in these downturns as opposed to getting a text through your robo-advisor on your computer is far more soothing and probably offers a little better advice and sounder, long-term strategic planning, yes?

Ms. MCNEELY. Absolutely, and specifically because I know their entire situation. We have spent countless hours talking through their specific issues, and so I know them personally and can give them much better advice.

Chairman DUFFY. What happens to your clients if this Department of Labor rule goes through? Do they still, in the same capacity, get access to your advice, do you think?

Ms. MCNEELY. As it is written right now, my feeling is that likely I would not be able to work with a large number of my clients because I do have a very small asset base with a lot of my clients, they are new savers, so it will likely preclude me from working with them because I will be subject to some asset-based limits.

Chairman DUFFY. Yes, we don't come from a very wealthy area, do we?

Ms. MCNEELY. No, sir.

Chairman DUFFY. Yes, I would agree with that.

Mr. Stevens, I was intrigued by the analysis that you all have done in regard to the true cost of this proposal. The cost isn't a $17 billion cost, it is much higher than that if this rule was to go through, is that correct?

Mr. STEVENS. Yes, Mr. Chairman. And I think we have spread this analysis on the record in comment letters, in testimony up here on the Hill and to the general public.

And what I would say to you is that no one, no supporter of this proposal has yet to come to the ICI and said, here is why your numbers are wrong; that includes the people at the Department of Labor who have been working on the bill, as well as the academics whose studies the Department of Labor was relying upon.

So if we have this wrong, we would like to know. But no one has challenged our numbers yet, and I think they are exactly right because the Labor Department process was deeply flawed.

Chairman DUFFY. So what are the biggest flaws of their analysis? And what are the biggest numbers that they missed, in your opinion?

Mr. STEVENS. First of all, as I say, they have predicated the whole thing on studies that were out of date, depicting a market that doesn't exist anymore.

Chairman DUFFY. How old?

Mr. STEVENS. One that is typical of 10, 15 or 20 years ago. In fact, that is one of the critiques I would have with Professor Bullard's analysis, as well.

The truth is, over the past 10 years virtually every penny that has gone into a mutual fund has gone into a no-load fund. In fact, the funds that have sales charges associated with them, front-end sales charges which is the subject of what the Department of Labor talks about, have had outflows, very substantial ones, for all of the past 5 years.

On average, for those funds that actually do have a load, and that is a small part of the market now, what an investor paid is .9 percent as a sales charge on a hybrid fund or a stock fund, that is the average, and on a bond fund .7 percent. So there is not this vast disparity, there are not these huge costs embedded here.

All of this is publicly available information that the Labor Department didn't take into account.

Chairman DUFFY. The costs have not gone up in recent years; they have actually down, I think.

Mr. STEVENS. Oh, it has gone down. The costs of fund investing and 401(k) funds has gone down for a generation.

Chairman DUFFY. I have to interrupt you. I was going to try to run a tight gavel, which I talked to the ranking member about. We have a lot of witnesses today and I have violated the first rule by going over by 40 seconds. I apologize.

The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch, for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

I want to thank all the witnesses for your willingness to come before the committee and testify. This is an important issue.

I do agree that the greatest danger here is leaving the small investor without advice. That is the greatest danger. And so I think the goal of the committee is to try to find that balancing point where the small investor, as Professor Bullard has described, is protected from the irrefutable conflict of interest that is out there to steer certain products because of the greater compensation afforded to financial advisors.

This is especially important, I think, the private-side-retirement industry is so important because of the impending and long-term weakness in the Social Security system. So we have to try to optimize and maximize the benefits to retirees just because of the demographics here. We have to figure that out.

And I know there are a lot of great financial advisors out there who do the right thing every single day. There are some bad actors and they get a lot of the attention, but look, I was an iron worker for 20 years and if we did not have financial advisors who helped us plan for the future, there would be a lot of families who wouldn't have that protection, so we have a really keen interest in finding the right balance here.

The DOL, and a number of you have said it, I think their intent is, I think their incentive here is well-intended. There is a situation out there with conflict of interests that does disadvantage small investors and future retirees.

And Professor Bullard, I want to ask you, there is a 2013 GAO report that talked about IRA rollovers and that at least in that

small instance that a lot of folks were getting bad advice and that it wasn't necessarily in their best interest about rolling over their IRAs.

Can you tell me what type of retirement advice or services would be prohibited under the rule that the Department of Labor is now proposing?

Mr. BULLARD. I am glad you mentioned the GAO study. For those who are interested, you can actually listen to some of the calls that they recorded where registered representatives were essentially lying about IRAs not imposing fees. And that is exactly the kind of abuse that the DOL is trying to put an end to.

Now, the effect will be that when somebody makes a call to one of these call centers and, subject to FINRA rules, they are already required to ensure the recommendations they make are suitable, that they are not allowed to make recommendations when those recommendations would result in the call center personnel being paid more for recommending one thing than another.

There is no effect on what the broker-dealer gets paid, it has no effect on what the branch manager gets paid. You only have to make sure the call center employee does not have an incentive to get paid twice as much for selling the stock fund than the short-term bond fund, and that would be the effect of the rule. So they wouldn't have the incentive to misrepresent IRAs being cost-free.

Now, there is still the problem that they have an incentive to move them out of the 401(k) and that is going to obviously put money in the pocket of the advisor, that they wouldn't otherwise get if the money was still in the 401(k).

Ultimately, you can't address that conflict. That is inherent in asking for advice. And the Department's rule unfortunately would not prevent that. But there really isn't a way to prevent that. But at least it would make sure that you had to disclose fully what those conflicts are and how they are getting compensated and that you had to make sure that person did not have a direct financial incentive to recommend one thing over another.

Mr. LYNCH. What about a number of very good companies that have been in business for a long time and have done great work in helping individuals with retirement plans? A lot of those groups have come up with alternatives for this best-interest standard. Tell me why their approaches are inadequate?

Mr. BULLARD. In some cases, they have actually taken the same steps that the Department would require, while saying at the same time that they are unworkable. Raymond James has eliminated retroactive payout grids. Apparently, other firms think that is unworkable.

Some have put caps on commissions paid, for example a 4 percent cap on the amount that a financial advisor can be paid for selling a fund. The industry says that is unworkable.

Some have product-neutral payout grids, in other words you don't get paid anything more for selling one product or another. The industry says that is unworkable, but there are broker-dealers that are currently out there doing that.

There are some that actually have gone much further than what the Department would require. They have had neutral compensation for variable annuities versus non-variable annuities. The De-

partment does not require that. They have neutral compensation for platforms and proprietary funds and other funds. The Department does not even require that, yet there are industry members whom FINRA has documented are already engaged in those practices.

So when the industry says things are unworkable, what I would like to know is how is it that a number of broker-dealers are making them workable without even already being required to do so?

Chairman DUFFY. The gentleman's time has expired.

Mr. LYNCH. Thank you.

Mr. Chairman, my time has expired. I thank you for your indulgence.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from New Jersey, not from New York, Mr. Garrett, for 5 minutes.

Chairman GARRETT. Thank you. Right. Thanks again.

I will start with you, Mr. Stolz. So you have heard the testimony that I have heard so far from the professor.

Mr. STOLZ. Yes.

Chairman GARRETT. Talking about the conflict of interest here, how does that actually play out in reality, however? There are other rules that you have to go by, right?

So in other words, Mr. Callahan, you were talking about your parents, $25,000.

I think, Mr. Stevens, you said there are over 100,000 people in that category in the State of New Jersey, in that level.

So you have somebody coming to you with $25,000. I am not going to guess how old your parents are, Mr. Callahan. My parents, my mom is 91, so if she comes to you with $25,000 and that is her life savings to invest, now, the professor is suggesting that the only thing that they are going to be looking at is the $80 versus the thousands of dollars. But aren't there other rules that apply? Isn't there, without saying what the rule is, well, I will, suitability that applies there that would counter any of those other incentives?

Mr. STOLZ. That is correct. The part or the piece of the puzzle the professor is leaving out is that there are procedures in place to make sure that the recommendations are based on the needs of the client and not on the compensation plans that the individuals have. And we have entire compliance Departments whose role is to oversee these things, then they will run reports that will indicate if any advisors are over-concentrated in different areas or going too far in one way, et cetera.

Chairman GARRETT. Right. And if there is a violation of that, don't we have years of case law to go and look at this to say what suitability is and what suitability isn't?

Mr. STOLZ. That is correct. And the example the professor gave where individuals lied about the IRAs, current law would take care of that. If somebody misrepresented the way that the product works or the plan works, that would be covered under current law. We don't need the Department's rule in order to add to that.

Chairman GARRETT. So we know what the rule is today, right?

Mr. STOLZ. Correct.

Chairman GARRETT. We know what the standard is today, right? We know the courts have interpreted this, right?

Mr. STOLZ. Correct.

Chairman GARRETT. But now we are going down a whole new road with the DOL, aren't we? They have something as far as what is reasonable instead as far as their proposal. Do we know—let us go down the road. Is reasonableness defined in the DOL-proposed rule?

Mr. STOLZ. The current proposal states that compensation must be reasonable. It is not defined.

Chairman GARRETT. Right.

Mr. STOLZ. And that will certainly be one of the issues. What is reasonable to you might be very different to someone else.

Chairman GARRETT. Right. And so if it is not in the statute, it is not in the rule, it certainly, therefore, has not been defined by any courts at this point in time, so it is just totally ambiguous to all parties involved. How does that play out then for the investor going into it?

Mr. STOLZ. Put yourself, I guess, in the shoes of the advisor. Knowing that any recommendation you make is subject to be second-guessed, you are going to make those recommendations in part on what is going to reduce the chances it could be second-guessed.

It is kind of like a doctor submitting tests that may or may not be necessary in order to make sure that they cover their bases for any potential lawsuit.

What that means is I am not going to be making the recommendation always solely on what is the right choice for the client because I have to consider what would happen if my recommendation is wrong and what would that lead to as far as potential litigation.

Chairman GARRETT. Exactly. And let me give you a real-life example. We are losing a good guy over at the SEC, Dan Gallagher. And he said recently, talking about the DOL rule, "Their rule is grounded in the misguided notion that charging fees based upon the amount of assets under management is superior in every respect to charging a commission-based fee."

In the next 25 seconds, let me just give you a real-life example. And maybe I will go to Mr. Callahan. You gave the numbers.

So you have a guy who is 30 years old, a young guy coming in with $25,000 to invest or something like that to his advisor. And he says, let's put it into a low-cost strategy, such as into a fund, and we will re-look at this every few years during the course of your life, if you get married or some other things or there is turmoil in the markets, what have you.

If you are going on an assets-based manner of doing it, you will be paying, what, so much amount each year on that with the money basically just sitting, not in the bank, but sitting in the fund. Right?

Mr. CALLAHAN. Right.

Chairman GARRETT. Conversely, if you do it the way you might do it now on commission, you will be just paying it once. Right?

Mr. CALLAHAN. That is correct. So it depends on how long they are going to hold the investment. And let me take a step back just to show you how challenging this rule would be in practice in that scenario.

Chairman GARRETT. Okay.

Mr. CALLAHAN. So you took the ERISA framework of fiduciary definition and apply it to an IRA, just for the sake of argument, where there already is SEC oversight with the fiduciary. So you have two fiduciary standards competing that are not clear.

Chairman GARRETT. Yes.

Mr. CALLAHAN. The SEC has actually come out to us, we are regulated under a best-interest standard already with the SEC, and said, hey, there are times when you should not put a client's money in the fee-based account, you should put it in the commission account because over the long run it will cost them less money.

Chairman GARRETT. Right.

Mr. CALLAHAN. So here you are sitting—so the SEC with the best-interest standard is telling you, hey, you need to put it in this bucket and now this new rule under ERISA comes in and says, oh, no, you need to put it in that bucket. You say, okay, there is math, there is economics and now there is regulation and they are all saying different things.

Chairman GARRETT. Right. Bottom line, unworkable.

Thank you.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Okay, thank you, Mr. Chairman.

Ladies and gentlemen, I see this rule as sort of like putting our financial system, our financial advisors in a straitjacket. That is what this does.

And let me just point out some very salient points that disturb me about the rule. One, to remove and to replace the compensation package for financial advisors from being commissioned to a fee for service will directly have a devastating impact on those folks at the low- and middle-income ends of our economic stream.

Secondly, this business about the best-interest contract is well-intended, but when you put the word "contract" out there, that has legal sanctions and it will bring untold lawsuits on the one hand, and on the other hand, it will frighten basically the very consumers that you are trying to reach, those with low and moderate incomes, who could be suspicious.

For example, when you go and you approach a client and you say, well, we would like to work with you and your investments for retirement, they say, okay, fine. First of all, you have to pay me a fee before I can go any further. And then, oh, really? Yes.

Then second, you have to sign a contract.

Now, I would even run away from that because those things have a devastating impact, particularly in the African-American community.

I was able to get a letter that was written to Secretary Perez at the Labor Department. And the letter was from the African American Chamber of Commerce. And here is what it said, "We continue to be very concerned that the Department of Labor has proposed a rule that will severely restrict African Americans in this country and also low- to moderate-income Americans' ability to save for retirement. And the new regulation also will make it difficult for our members, as small-business owners, to sponsor retirement savings plans for themselves and for the benefit of their employees.

And as a small-business owner myself, I relate so well to this.

Ms. McNeely, you work with small businesses, small-business owners and helping them establish retirement saving plans. Do you agree with what the African American Chamber of Commerce is saying?

Ms. MCNEELY. Wholeheartedly, sir. They definitely have hit it right on the head.

Mr. SCOTT. Right. And let me go in my next time, I want to get to the best-interest contract.

Mr. Stevens, was I correct in my analysis of what would happen with the best-interest contract? And I know that the Labor Department senses that as well and that is why they offered this exemption for the best-interest contract.

But when you look at this exemption, it is an extraordinary, complex, complicated puzzle which requires an untold amount of work. Give us your opinion on this best-interest contract, the devastation it would have and also how unworkable this exemption is?

Mr. STEVENS. Congressman, I think you have hit the nail right on the head. The problem with this exemption is that every bell and whistle imaginable has been added to it. And for the life of me, as I look at it, I believe it is an exemption that perhaps the Labor Department doesn't think anyone will ever take advantage of.

It will be so cumbersome, so expensive. It is not just the three-way contract they have proposed between the call center representative or the individual representative plus the customer plus the firm that has to be entered into, massive disclosure obligations are associated with it, some of which actually involve violations of the securities laws because you have to predict performance out into the future in order to provide those disclosures.

There are massive potential liabilities, including new class action lawsuit potential brought under State law that does not exist now.

Mr. SCOTT. Right.

Mr. STEVENS. In fact, in addition I would tell you that when they did the economic analysis, they essentially said one of the things that will be good about this rule is that there won't be anymore commissions paid.

That signals to me that they really don't think anyone is going to use this best-interest contract exemption and they wrote it with that in mind.

Mr. SCOTT. Right.

I want to say in my conclusion, Mr. Chairman, if I may, a similar approach to this was taken in the United Kingdom and it resulted in 11 million people going without investment advisors. This is not something we want to see happen in the United States.

Chairman DUFFY. The gentleman yields back, and point well made.

The Chair now recognizes the vice chairman of the Capital Markets Subcommittee, Mr. Hurt, for 5 minutes.

Mr. HURT. Thank you, Mr. Chairman.

I thank you, sir, and Chairman Garrett, for hosting this important hearing.

I represent Virginia's 5th District, a rural district in southern Virginia, central Virginia. Over the last month we have had the op-

portunity to travel across this large district and spend a lot of time on Main Street in all the localities that we represent.

And I guess what I bring to the table today is certainly the idea that so much of what comes out of Washington, while well-intended, so often ends up making things more difficult, whether it is the President's health care law and the costs, the unimaginable costs that are being now imposed on so many Americans, whether it is the Dodd-Frank Act and the limiting of consumer choice and the rising costs of accessing capital.

All these things hit our Main Streets particularly hard and, frankly, harder than places like Wall Street.

And so what I hear from the people that I represent is we need to be looking for every way to make things easier, not more difficult. And I fear that this rule, as proposed, is going to do just that. It is going to make it more difficult, more costly, with fewer choices and less innovation.

In August, after Mrs. Wagner led a letter to Secretary Perez, he responded. He said, "We have received your letter of July 29th regarding the DOL's proposed conflict of interest rule which would require that retirement advisors put your constituents' best interests before their own profits." And then he goes on with a government-knows-best tone and says, "This is a simple premise presented with an open mind."

And so I guess my first question would be to Mr. Stevens for your comments as it relates to the Secretary's statement that this is a simple premise and that it is presented with an open mind, because from everything that I have heard today and everything that I have read about this subject, it is neither simple, nor does it seem that the Department of Labor is approaching this with an open mind.

Mr. STEVENS. Congressman, I must say we have worried about the process that has been followed here. You must remember this is the second time a proposal of this sort came out. They worked on one, proposed it 4 years ago and it received enormous criticism and they withdrew it.

And they then went back to their Department and for 4 years it was a black box. They weren't consulting with people about what the rule proposal would be. There was really no transparency into what then emerged after a 4-year period.

Our members are very concerned that there is a march-to-the-sea potential here, despite what the Secretary may be saying. And remember, there is no grandfathering so every existing relationship between a financial advisor and a retirement saver is implicated in this proposal. And they have proposed an 8-month implementation period for a massive overhaul of this part of the retirement market. Why? Because it coincides with the end of the Administration.

So there is an agenda at work here, we fear, and frankly that is why we have been positively inclined towards Congresswoman Wagner's bill.

The worst possible thing that could happen is that this proposal be adopted in anything like its current form. And in order to forestall that, if we have to say let the SEC go first, we think that is infinitely preferable.

Mr. HURT. Excellent.

Mr. Callahan?

Mr. CALLAHAN. I would echo Mr. Stevens' remarks so much so that I believe that letter was sent by Secretary Perez during the middle of the public hearings. And what could be more indicative of the mindset than during the middle of the hearing before you have gathered all the information, you have sent a letter making a conclusion?

So I would agree that it is not a light touch, so much that the CEO of FINRA says this is not business-model neutral and will result in a fractured approach. That is the regulator of the existing regime disagreeing with Secretary Perez.

But I go back to the nature of what we are doing. Does this sound simple to you? We are taking a framework of fiduciary duty that was established for ERISA plans, corporate plans, sponsored plans, where the main goal was saving money, minimizing fees in these big plans. We are parlaying that over into the individual retirement space, very different needs, very different needs of access.

And we admit right from the beginning that a lot of the tools that we use are prohibited. That is why we need exemptions. So we are starting with a rule that says things are prohibited and from day one we begin peeling the onion backwards to fit it in an arena that it doesn't belong.

I would just challenge the committee to help send a message to the Department that the problem that we are trying to solve is providing consumers more access, giving them this robust framework that is confusing and complex, that arguably could be strong on the back end for fixing remedies.

Why would we not simplify it, follow the 408(b)(2) disclosures that the Department has modeled, give them on one piece of paper the key points of information they need to make better decisions up front to prevent decisions from needing to be unwound?

Mr. HURT. Thank you. Thank you, Mr. Callahan.

My time has expired.

Mr. BULLARD. If I could just add to correct some of the actual misstatements and misrepresenting what the law is.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman.

About 13 of us over on this side supported a similar bill a couple of years ago. And that bill was a little narrower in that it simply told the SEC to go first. It didn't then lay out a bunch of things that the SEC would have to do, which would make the SEC operate more slowly. It is a little harder to get support on this side of the aisle to tell the SEC to go first and then tell them to go slowly.

This process has lasted, like everything in government, far too long.

We have this bizarre circumstance where you have a choice between do we want to give investors freedom or protection. And one might argue for protection, one may argue for freedom. But what is absolutely absurd is to have one rule for my mother who inherited money from my father and is 86 years old, and one for a lot of people in this room who have IRAs and 401(k)s and similar programs.

If you are going to provide more protection and less freedom, you would think you would do that for my 86-year-old mother rather than for me. But we have a circumstance where the Department of Labor is providing the least options, they would say the most protection, not for those who don't have IRAs and 401(k)s and are 86 years old, but for people in this room.

It is absurd for us to have two different rules. But if we had two different rules we should reverse it and have the greater protection for those in their most senior years.

The other problem I have with this rule is it is written by economists who have this absurd belief that everyone else in the country is an economist and everybody they work with is an economist, and if everyone was an economist, I would be in favor of the rule.

And so we have no hand-holding, no help, nobody gets paid. You get to save as much money as you decide to save if you call the 800 phone number and tell them which index fund to put the money in. That is going to lead to a decline in total savings for retirement because everyone in my district who is not an economist wants to invest where they can talk to a person, who does need to be paid, where they have options, they will save more if they are allowed to invest in this or that or to make changes.

And to say that we are trying to sell ice cream, but we are only going to sell vanilla is not a way to sell a lot of ice cream.

I am concerned about the smooth transition for existing customers.

Mr. Stevens, I believe you have addressed that. You have talked about grandfathering, you have talked about the implementation period, and you have talked about existing clients. Are we supposed to have tens of millions of clients who have already, in many cases, paid the commission, be told that they have to jump through a bunch of hoops to see if they can still get what they have already paid for and to continue to save money for their retirement as they are successfully doing? What kind of implementation period and grandfather ruling would we need to be effective?

Mr. STEVENS. Congressman, was that a question for me?

Mr. SHERMAN. Yes.

Mr. STEVENS. I am not sure that if the rule remains unchanged, any implementation period is going to solve the problems it creates. We would need a long implementation period for a good rule. Eight months is certainly going to be ridiculously short.

Mr. SHERMAN. Let us say the rest of the rule was a little better than it is now. What grandfathering and implementation provisions would you call for?

Mr. STEVENS. I think one very simple approach would be to simply say existing relationships are not affected by this rule.

Mr. SHERMAN. Okay.

Mr. STEVENS. That solves the double charging going forward.

Mr. SHERMAN. At least with the amounts that have already been invested.

Mr. STEVENS. New relationships that are established could be affected by it. That would certainly narrow its impact.

Mr. SHERMAN. I want to sneak in one more question. That is basically, is robo-advice going to work for the less-tech-savvy, for the

elderly and for people who are just a little bit reluctant to save for retirement when that means they can't buy a boat?

Mr. Callahan?

Mr. CALLAHAN. No, it will not. And the data supports that. You talk about a 1 percent cost in this $17 billion. If you look at the Dalbar study that says what does the average investor without advice earn compared to any single asset class that they could invest, it is far more than 1 percent, it is 4, 5 or 6 percent depending on which asset class.

And why is that? It is behavioral. It is behavioral finance and a robot is not going to deal in the emotional side that drives behavior of selling at exactly the wrong times and buying at the wrong times.

Mr. SHERMAN. Thank you.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the chairman of the House Foreign Affairs Committee, the gentleman from California, Mr. Royce, for 5 minutes.

Mr. ROYCE. Mr. Chairman, thank you very much.

Last May I asked FINRA, the CEO there, Richard Ketchum, about the negative effects of the 2013 rule enacted by the British government that had such an impact on low- to moderate-income consumers in the U.K. and on whether enacting a similar rule, as the DOL has proposed, would have those impacts here in the United States.

Now, this is a point that Mr. Scott referenced. But there is a study in the U.K. which found that during the first 3 months of 2014, 310,000 British clients stopped being served by their brokers and the reason was because their wealth was too small for the broker to advise profitably, and an additional 60,000 investors were not accepted for the same reason.

And Mr. Ketchum concluded that, "the statistics here are certainly concerning. Moving to an environment where only advisory accounts are the only effective way to operate in the United States is a very bad step. And that with respect to middle-class investors, the availability of the choice between fee-only and commissions is important."

And since I spoke with Mr. Ketchum, the British government embarked on an official review of the impacts of its rule, all while the DOL claims that there is little evidence that investment advice has decreased significantly in the United Kingdom. That is the Department of Labor's argument while the British are in the middle of trying to get to the bottom of this impact.

And so, Mr. Stevens and Ms. McNeely, what caused the U.K. to initiate the review? Are they investigating whether the regulation has created an advice gap cutting off lower- and middle-income servers from investment advice? Is that your understanding of what they are looking at there?

And let me ask you that question.

Mr. STEVENS. That is my understanding, Congressman, that they are looking at a species of the same problem that we predict might happen under the DOL proposal. Remember, in my opening statement I mentioned 20 million individual retirement account holders

who have balances of $25,000 or less, that is 20 million people for whom the economics of a fee-based model are highly questionable.

It is interesting that Labor Department Secretary Perez has touted the idea of the robo-advisor as a solution here. The robo-advisors are a fairly new innovation. We love innovations in the marketplace and they may be delivering very good services, but it is hard for me to believe that an 8-month implementation period, this new approach to the provision of advice is going to suddenly be able to manage a 20-million-person-strong investor base that no longer has access to a commission-based model.

The other thing to say about robo-advisors is this is the same Department of Labor placing its faith in that won't allow retirement plan sponsors or service providers to use email to deliver plan documents.

So on the one hand we have this huge digital divide that requires us to continue to put out paper, and on the other hand, my gosh, let us have millions of people rely upon robo-advisors. It does not make sense.

Mr. ROYCE. And Ms. McNeely?

Ms. MCNEELY. I would concur and just say that I know advisors who are currently working in the U.K. and many of them had to let go of all of the small accounts that they had in their book of business simply because it wasn't allowed for them to be paid via commission.

And quite frankly, the smaller accounts, the smaller retirement savers, without question, it is far more cost-effective for them to use a commission-based model. And if they don't have that choice, we will see some significant challenges in continuing to give advice to the very people, from my perspective, who need our advice the most.

Mr. ROYCE. And Secretary Perez has stated unequivocally that the DOL's proposed rule would not have similar impacts to that of the U.K. rule. Let me ask you if you agree with that?

Ms. MCNEELY. I do not agree with that.

Mr. ROYCE. Okay. And I would ask the same question of Mr. Stevens.

Mr. STEVENS. I would not agree with it either, Congressman.

Mr. ROYCE. Ninety-eight percent of IRA accounts with less than $25,000 are in commission-based brokerage accounts. According to FINRA's comment letter, "Under the DOL proposal, many broker-dealers will abandon these small accounts. They will convert their larger accounts to advisory accounts and charge them a potentially more lucrative asset-based fee."

They will do so largely because of the ambiguity of the best-interest-contract exemption included in the DOL rule.

Do you believe these smaller savers, investors will—I think my time has expired, Mr. Chairman.

Chairman DUFFY. Your time has expired, Mr. Chairman.

Mr. ROYCE. Thank you. I will yield.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

And I thank the witnesses.

Mr. Chairman, I share some of your concerns about the fiduciary rule, so I am not being argumentative. But I am concerned about the fact that for something of this significance, why we wouldn't have someone here from the Labor Department. I had hoped to be able to raise questions with the agency and individuals who are in fact designing this rule. And so I am not fully happy that we don't have someone here.

This has nothing to do with those of you who are here. I just think that it would be infinitely more meaningful to me to be able to raise my questions with the folks who are in fact designing the rule.

And I actually was so concerned about it I talked with the Secretary last evening because I thought maybe they had refused to come or that the Department is on vacation or something.

So I don't understand why we couldn't have someone here, because I may have more concerns than you about this, but as eloquent as they are and nice and eloquent and very attractive—

[laughter]

Chairman DUFFY. Will the gentleman yield?

Mr. CLEAVER. —but they can't answer the questions that I want answered by the Labor Department.

Chairman DUFFY. Would the gentleman yield?

Mr. CLEAVER. Yes, please.

Chairman DUFFY. Listen, I think the ask coming from your side of the aisle to Secretary Perez would have been maybe a little better received, and you did have an opportunity to invite him. And we would have been open to having you guys extend an invitation to him. You make a very good point. I don't dispute the claim.

Mr. CLEAVER. Thank you. I am not mad; I just wish I could ask him some questions.

Professor Bullard, Mr. Callahan mentioned in his comments that it may not in fact be cost-effective to provide fee-based services to the smaller retail investors. So I am wondering if you believe that the impact of the rule will be an increase in the fee-based services as opposed to the commission-based?

Mr. BULLARD. The industry's criticism along those lines is premised on banning commissions, which is what the U.K. did, but what the Department decided precisely not to do. So the U.K. took a very different approach, and I disagree with, which is why the effect won't be the same.

That is one reason that it will have no effect on asset-based fees, but those accounts have been growing relentlessly, regardless of the DOL's proposal.

It is also false that the industry is unable to provide cost-effective fee-based accounts. Edward Jones has rolled out a plan that in the first 6 months of 2015, brought in more assets to its mutual funds than all but three mutual fund providers. Now, this is a broker-dealer based in St. Louis that is selling more funds than most fund complexes.

The way that they are doing it is they have introduced a low-cost, fee-based account that charges 1½ percent and then puts you in funds from which they have removed all the traditional conflicts of interest that proprietary funds have that range from 31 basis points, .31 percent, to about .55 percent.

In other words, they are offering a full-in, full-service program, the total all-in costs of which are going to be less than 2 percent. And Edward Jones should get credit for that. But at the same time, they are arguing that it would be impossible to offer affordable fee-based accounts.

In any case, the rule will have no effect on that because it doesn't ban commissions. But I do applaud the industry for continuing to show innovation and proving that yes, eventually there are going to be very affordable, full-service, fee-based accounts, and I think some other competitors in the same city really should be looking into that because Edward Jones is eating their lunch.

Mr. CLEAVER. With 27 seconds remaining, I am not going to have time to get to my next question, I don't think, Mr. Stolz, so I will yield back the balance of my time.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Ohio, Mr. Stivers, for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman, for holding this important hearing, and for making sure that we got a chance to ask this panel some questions.

I want to sort of take off on some of the questions that Mr. Royce from California asked when he talked about the U.K. proposal.

So it is widely accepted from public data in the U.K. that advisors refused to provide services to individuals with about less than 20,000 pounds in assets, which is the equivalent of $31,000 in assets here in the United States.

I am curious, and I will start with Mr. Stevens or Ms. McNeely, if you think that would happen here?

Ms. MCNEELY. Yes, I do. Currently, my minimum required balance for a fee-based account is $50,000 through my current broker-dealer. So I would not be able to accept a fee-based arrangement with any client unless they have at least $50,000. There has already been some speculation that amount may go higher as a result of the added liability.

Mr. STIVERS. Yes, I was going to say with the additional liability won't that actually potentially go up?

Ms. MCNEELY. There has been some talk of that, and I would expect that would happen to at least a hundred, I have even heard as high as 250.

Mr. STIVERS. And there were—so let me just tell you what some of the response in the U.K. was. HSBC only provided advice for folks with over $80,000 in assets, Lloyd's, over $160,000 of assets, World Bank of Scotland charges $800 to set up and makes changes based on your net worth of what kind of services you get face-to-face versus non-face-to-face, and Barclay's only provides investment advice for people over $800,000 in assets.

Avia ceased offering face-to-face investment advice. AXA ceased offering face-to-face investment advice; advisor firm AWD, deVere, clients over $80,000 in assets, and the advisor firm Towry was over $160,000 in assets.

So that is what happened empirically in Europe. I know it is not exactly the same model, but it certainly has the same implications, and so the numbers may be a little less than that here, but it will have some of the same effect, in my opinion.

Thanks for that.

Mr. Stevens, I had a follow up on, do you think the Department of Labor's economic analysis justifies this re-proposed rule?

Mr. STEVENS. As I have explained, we actually think it results in a very substantial increase in costs over 10 years, both in terms of lost investment performance for people who won't be able to access the advice that they need. And we estimate the total to be in excess of $100 billion.

So if that is the cost, you have to ask yourself, what is the benefit of this massive overhaul and its very expensive new set of arrangements?

And I think that the kind of cost-benefit analysis that goes into does not suggest that there is any real benefit for it.

I am struck by the comments from my friend, Professor Bullard, talking about innovations in our marketplace.

Mr. STIVERS. That was my next question.

Mr. STEVENS. People are trying to deliver these services in a different way, and I think we all ought to celebrate that. But recognize that under this new regime with the best-interest-contract exemption and the like, there is going to be a huge set of new costs and obstacles to that kind of innovation.

Mr. STIVERS. Thank you.

So Mr. Stolz, I want to take off on that point a little bit. Professor Bullard just made an impassioned plea for how innovation is helping solve this problem. Doesn't that sort of make the point that this isn't necessary?

Mr. STOLZ. You could certainly, I could certainly agree with that. And I think it is important that we understand when we say that it is unworkable, what is unworkable. It is not about being able to change compensation packages and schemes. That's the easy part. It is the fact that when you have to sign an individual contract that you are going to be personally liable for and you have all these disclosures that you have to do is the part that is unworkable.

And while advisors have an option under the proposal to have a commission option—

Mr. STIVERS. I want to do one more question, but I appreciate your innovation and Edward Jones and all the people who are innovating.

And my last question is for Professor Bullard. I am really concerned. So the individual contracts, you have to sign before you provide advice. I am a soldier, and have been a soldier for 30 years. I happen to use USAA for a few things. Their business model explodes under this plan, doesn't work because soldiers are deployed all around the world. What do you say to those soldiers who can't get advice because they can't sign a contract?

Mr. BULLARD. I agree on this issue, and I think the DOL has at least suggested, and I wish they would be more forthcoming, that they are not going to require you to send out the contract, they are not going to require that it be returned signed, and they are not going to adopt a number of the proposals they have made.

This is a proposal. What H.R. 1090 would do is essentially prevent an administrative agency from making proposals. And I would like to see what they actually finally adopt before we decide to try to throw the SEC interference in front of it.

Chairman DUFFY. The gentleman's time has expired.

Mr. STIVERS. I yield back my nonexistent time, Mr. Chairman.

Chairman DUFFY. The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. I thank the chairman and the ranking member.

Should retirement advisors be able to put their own profit-seeking before the best interests of their client?

Ms. MCNEELY. I would be happy to answer that.

Mr. ELLISON. I wish you would answer it directly.

Ms. MCNEELY. I promise I will.

Mr. ELLISON. Do you say yes or no?

Ms. MCNEELY. They should not be. And they don't.

Mr. ELLISON. Okay, so you think best interest is the right thing.

Ms. MCNEELY. Absolutely, and I already operate in the best interest.

Mr. ELLISON. Does everybody agree with that? Everybody is for best interest?

Mr. STEVENS. Yes.

Mr. ELLISON. Now, let me tell you. I talked to the people at DOL, and they told me that this thing about having to sign before you talk has been misrepresented. They said that you can talk, but before money starts passing then there is going to have to be a contract, which I am familiar with. I practiced law for a long time. We have retainer agreements. And you can talk to your client about the case, but then when they start talking about paying you, you have to sign up so they can know what they are getting and what they are not getting.

So I really believe this thing about, oh, you have to sign up before you talk is a red herring.

So let me ask you this question. Much has been said about the U.K. example. And is that fair, Mr. Bullard?

Mr. BULLARD. I don't believe it is. I quote, for the members of the subcommittees, the provision in the U.K. proposal in a footnote in my testimony. And it is very clear what they banned was product-set compensation—

Mr. ELLISON. Now, Mr. Bullard, let me ask you this question, too. So here is the other thing. You talked about Edward Jones offering products that were innovative. Does the fact that they are innovating in trying to meet the needs of certain market participants, is that somehow evidence that this rule, this fiduciary rule is unnecessary?

Mr. BULLARD. No, not at all. In fact, what I would like to see is more innovation such as attempts to mitigate or eliminate the conflicts that the Department is going after. And firms like Raymond James, to their credit have done that with respect to some products. They have eliminated retroactive—

Mr. ELLISON. Now, forgive my lack of being polite. But Mr. Stevens seemed to, and I don't want to mischaracterize Mr. Stevens' point of view, but it seemed that—I will scratch that one because I have so limited time.

Let me ask you this question. What is the cost of not putting a best-interest standard in place? I am sure that most—Ms. McNeely makes the point that most advisors are great people, and I believe

that. Certainly in the 5th Congressional District, they are all awesome.

But my point is, what is the cost? Because the DOL says that there is a cost to people having hidden fees and all kinds of stuff and the status quo has its own cost. Could you elaborate on that?

Mr. BULLARD. Yes, there is no question the costs would be, and this is where an advisor makes a recommendation, in part or in whole, because it pays them more money and it is not in the best interests of the client. And there is plenty of data that show, for example, that is a motivation in some cases. It is empirically proved.

There is a study of a retirement plan in Oregon that shows explicitly you can show that the allocations where there is additional compensation being made going more often to the ones that pay a higher compensation.

But you don't really need a study to show you that. That is a rational requirement of economics that if you pay more for something you get more for it.

The question is, how big is it? We could figure that out if the industry would provide the data. We know how many crib deaths there are in America because that industry will provide that data. The industry refuses not only to provide the data where we could determine the effects of the conflicts of interest, they won't even provide the data of the studies they put forward on which they base their analysis.

Mr. ELLISON. Mr. Bullard, forgive my interruption again. So back in the day when my dad and his dad were working at the auto plants, they could get into a pension and you had somebody who knew how to manage a portfolio for them as they were busy making cars. We don't have that. We have it today, but it is shrinking and it is changing to defined contribution, we are moving to that now.

Who is helping you make good investment decisions now? You are basically on your own, right?

Mr. BULLARD. That is right. And a big impetus behind this is that the money has now moved from 401(k)s to IRAs where there is now more money than in 401(k)s.

And Mr. Callahan says that it is the Department that is imposing ERISA to IRAs. That is not true. It is Congress that imposes ERISA standards on IRAs. And virtually all the criticisms is a question for Congress to take up with its own statute. The Department is simply doing what it is required to do, which is to impose a higher standard for retirement assets than on our other assets.

Mr. ELLISON. Thank you, I am out of time.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

I have lots to cover, so we are going to do some rapid-fire here. And I thank you all for being here.

Mr. Callahan, I would like to first start off with a quote that Secretary Perez stated at the Senate HELP hearing back in July, where he said that the DOL is listening to industry concerns and will make, "material changes in a final rule."

Given your experience, would you say they are prepared to make the necessary and significant changes to prevent average retirement savers from losing choice and access to financial advice?

Mr. CALLAHAN. No. And when I testified at the public hearing they were very clear that they do not intend to do so. Their fixes would be tweaks operationally. And it is very clear that—

Mrs. WAGNER. Operational tweaks on a nearly thousand-page proposed rule. Thank you.

The DOL has already said they wouldn't re-propose the rule, as we have talked about, which would seem to be necessary if in fact material changes were to be made.

I have had numerous letters back and forth with all sorts of folks in the Department of Labor. I can't get Secretary Perez to return my call like Mr. Cleaver can.

But Secretary Perez himself responded to me in a letter saying so before the public hearings at DOL even began.

I want to submit this, Mr. Chairman, for the record. This is a letter that I received on August 7th saying they would consider no re-proposals, no material changes whatsoever. August 7th it is stamped as received in my office. I don't know when he sent it. But the hearings didn't begin until August the 10th.

So I ask unanimous consent to submit it for the record.

Chairman DUFFY. Without objection, it is so ordered.

Mrs. WAGNER. Would it seem from that response, that the DOL is in fact listening to industry and investors' concerns when they have completely ruled out a re-proposal of the rule before the comment period had even ended, Mr. Stevens?

Mr. STEVENS. It seems as though the issue has been prejudged. The agency is supposed to, under the Administrative Procedure Act, be sorting through what is a vast administrative record before them prior to making decisions of that nature.

Mrs. WAGNER. I agree. And is the Secretary's decision to that ruling out of a re-proposal during the comment period consistent with the Administrative Procedures Act, Mr. Callahan?

Mr. CALLAHAN. No.

Mrs. WAGNER. Mr. Stevens?

Mr. STEVENS. As a lawyer, I would say no.

Mrs. WAGNER. Mr. Bullard?

Mr. BULLARD. Yes, they can.

Mrs. WAGNER. I can't imagine how you can say yes.

Ms. McNeely?

Ms. MCNEELY. No.

Mrs. WAGNER. And Mr. Stolz?

Mr. STOLZ. I will make it the fourth no.

Mrs. WAGNER. All right.

Ms. McNeely, if the DOL can't be counted on to produce a working final rule, given the significant comment and feedback they have received on their proposal, it seems that a legislative solution would be needed. How will the Retail Investor Protection Act help prevent these market disruptions?

Ms. MCNEELY. I think it will hopefully eliminate some of the confusion out there, both for brokers and for consumers. And quite frankly, for me it will provide a lot of clarification as to how I can operate and continue to serve my clients.

For 20 years, I have been doing this. And I would love to continue to serve every client who walks in the door, regardless of the size of the account that they have to invest.

Mrs. WAGNER. And we in fact have a ruling through Dodd-Frank in Section 913 that the SEC could move forward on this, not the Department of Labor, not in their lane, not their purview.

Mr. Callahan, how will the Retail Investor Protection Act help prevent these market disruptions?

Mr. CALLAHAN. I think it empowers the agency that has a long-tenured experience with currently overseeing IRAs in a fiduciary capacity to take the lead and require them to do the analysis that will help quantify the problem in a way that the solution or the prescription is more clear and targeted in what exactly it is trying to solve as opposed to this blanketed approach with a number of unintended consequences, which my fellow panelists have testified to today.

Mrs. WAGNER. We have heard some discussion here, in my limited time, about the U.K. And considering that the implementation date for the rule is 8 months, when can we potentially start seeing signs of the same thing we are seeing in the U.K. right now, which is what they are calling the advisory gap, here in the United States, Mr. Stevens?

Mr. STEVENS. I think the nature of the proposal is such that if it were adopted without material change, you would begin to see that almost immediately, because firms will have a very short period of time in which to alter their business models with vast potential liabilities 8 months hence.

Mrs. WAGNER. I thank you very much.

Mr. Chairman, I have so many more questions. I would only say to my colleagues that if anyone would like to yield me some time, I would be ever so pleased to accept it.

With that, I will yield back my 5 seconds.

Mr. SHERMAN. Mr. Chairman, I yield the gentlelady all of my remaining time.

[laughter]

Chairman DUFFY. I think yours has expired.

[laughter]

Mrs. WAGNER. Mr. Sherman.

Chairman DUFFY. The gentlelady yields back.

The Chair now recognizes the ranking member of the full Financial Services Committee, the gentlelady from California, Ms. Waters, whom I am sure will consider yielding you some time.

[laughter]

Ms. WATERS. Thank you very much, Mr. Chairman.

This question I will address to Professor Mercer Bullard: H.R. 1090 requires that before the SEC can harmonize the fiduciary standard for brokers and dealers with that of investment advisors, the SEC must first publish a report finding whether retail investors are being harmed by the different standards of conduct.

Can you discuss the level of confusion faced by investors regarding the duties owed to them by investment advisors versus financial advisors who work for broker-dealers? Do customers or consumers understand that these financial advisors aren't subject to

the same fiduciary duty to act in their best interests? Has the SEC considered this question to date?

And given your understanding of the evidence on this issue, can you describe what Congress did under Dodd-Frank related to this and why the SEC to move forward to raise the standard of care owed to customers by broker-dealers?

Mr. BULLARD. The source of confusion is that when you receive personalized, professional services from doctors, from lawyers, when you give a confession to your priest, they do not have a financial incentive, and are not allowed to have one, to change the advice they give you based on how much they get paid. But investors naturally assume that they would be protected by fiduciary duty. They are not.

The confusion is exacerbated by the industry which consistently represents their representatives as financial advisors and they state that they hold themselves to a best-interest standard.

But Payaba has produced an interesting document that shows time and time again that in arbitration the industry takes exactly the opposite position and it includes quotes where you will see in every single arbitration case where broker-dealers deny that they owe a best-interest standard or that they are fiduciaries.

Now, the effect of that confusion is that they rely and have placed trust and confidence in broker-dealers that are not held to the standard that should apply to them.

And I agree, the SEC should, some time ago, have done a rulemaking. And I think probably everyone on the panel agrees. But the SEC, as I document in my written testimony, for the last 15 years has exhibited a level of rulemaking paralysis that is unprecedented.

And for the Capital Markets Subcommittee to want to delay anything while the SEC does rulemaking, I think is the height of hypocrisy. This subcommittee knows better than anyone that the SEC on these types of issues appears to be incapable of doing rulemaking and their only formal positions on this issue have been to oppose a fiduciary duty.

They adopted a rule that stripped the fiduciary duty from broker-dealers that charge asset-based fees, and they take the position of the advisors that commission-based broker-dealers are not subject to fiduciary duty.

So if you were going to delay rulemaking, at least the SEC is the last agency on earth for which you should be waiting for anything to be done.

Ms. WATERS. Well said. Having explained that very thoroughly, I will tell you what I am really worried about. I am worried about the wealth gap that exists between minorities and whites. And it is growing.

And for those small investors who are depending on good advice and don't understand that they may be getting advice from people who are conflicted because they are steering them into investments that will harm them oftentimes. What else can be done except insist on fiduciary for all advisors or people who are literally saying to folks, I am helping you to determine your future, I am helping you to determine your retirement?

And given what you have just described about the SEC and this committee, what other advice could you give to us and the public about how we can protect the most vulnerable people in our society?

Mr. BULLARD. I encourage the committee to support the Department of Labor's efforts. But otherwise, if it disagrees with the Department's approach, then to answer the question I posed earlier, which is, do you think it is appropriate to get paid twice as much for selling a stock fund than a short-term bond fund? If you think that is appropriate, do nothing.

Is it appropriate to choose between getting paid $80 and $29,000 based on the recommendation you make? If that is appropriate, do nothing. But if you think that is not appropriate, then propose a fix.

If you disagree with a higher standard for retirement assets than non-retirement assets, then change ERISA because that is the source of that law and it misrepresents what the Department is doing to claim it is the Department that is imposing that standard on IRA assets. That was Congress' decision and it is doing what it is required to do.

And if we want to use examples of Mr. Stevens' son or Mr. Callahan's mother, let me tell you about my father-in-law. He was a Captain in the Navy, he served 30 years. He was put into non-traded REITs in his IRA. And I looked them up and they charged 10 to 15 percent in commissions right off the top. He was also put into about a dozen mutual funds, the amounts of which showed that the intent was to get below breakpoints that would have allowed him to get lower commissions.

Now, I think he wanted to leave my wife more money than was allowed because of the standards that Congress has allowed to stay in place and that FINRA and the SEC have no problem with. But I think after 30 years serving this country, he deserved better.

Chairman DUFFY. The gentlelady's time has expired.

Mr. BULLARD. Excuse me for—I came to this hearing to be able to speak. And I know you are not interested in what I have to say, but I have never been cut off like this before in the 22 times I have testified, Chairman Duffy.

Chairman DUFFY. The gentlelady's time has expired.

Ms. WATERS. Thank you very much. So what in essence you are saying is this deal or proposal makes good sense.

Mr. BULLARD. Absolutely.

Chairman DUFFY. The Chair now recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you all.

We are limited to 5 minutes, and it is the only time we get to ask questions. So I appreciate all of you being here. This is a very important discussion certainly facing all American families. Almost 40 million households have not saved anything for retirement and 62 percent of Americans age 55 to 64 have less than one year's savings.

As we have heard today, instead of appropriately coordinating with the SEC, the Department of Labor is aggressively pushing a flawed rule which might be a political win for the Obama Adminis-

tration, but would come at the expense of retail investors trying to save for retirement.

The proposal would restrict access to investment advice and put in place obstacles that would discourage hardworking families from preparing for the future.

Furthermore, the Department has chosen to completely ignore the benefits of financial advisors, including relatively simple advice such as not making any irrational decisions in volatile markets like those we have recently observed.

Less-sophisticated investors, the investors who would be most impacted by the rule, may not receive the advice they need if the Department's proposal goes into effect.

In fact, many of my constituents tell me they save more because of the advice that they get.

I want to first thank my 43 colleagues who signed a letter that I sent to the Labor Department, which underscores one of the many flaws of the proposal, listed options would no longer be permissible in retirement accounts, however they would remain permissible in non-retirement accounts.

Subsequently, Democrats such as Congresswoman Maloney and eight Democrats in the Senate have made the same point. Options are an effective risk-management tool for people saving for retirement.

The Department's treatment of options is just one of the many glaring mistakes that would not have been made by the financial regulator with primary jurisdiction over these products, the SEC.

My first question I want to address to Mr. Stolz. Are there low-risk retirement investment strategies that make use of options?

Mr. STOLZ. Absolutely. Most options are used as a hedging strategy to protect against swings in markets, similar to what we have just seen. And so prohibiting those within IRAs would actually make the returns more volatile for clients.

Structured contracts would be another product that is very similar in nature. They are more conservative investments and give individuals a way to participate in the market without some of the downside.

So clearly, we have been in favor and our comment letter suggested that have wholesale product exclusions is not the appropriate way to go. If we just have the proper disclosures, that should do it.

Mr. HULTGREN. So Mr. Stolz, why would the Labor Department proposal discourage saving for retirement, other than that they simply do not understand this market and existing regulations as well as the SEC?

Mr. STOLZ. I guess it is up to interpretation. Did they leave these securities out because they didn't think they were appropriate? Or did they leave them out because they didn't understand how they were used? My guess is it was a little bit of both.

And no matter which answer it is, I find it a little bit alarming because an agency that would understand our business would know that they should leave investments like that as available for individuals who want to use them.

Mr. HULTGREN. Thanks, I absolutely agree.

I want to address this next question to Mr. Stevens. And I want to thank my colleagues from Illinois. I thank my colleagues, 43 throughout Congress, but also the Illinois delegation, which worked with me on a letter to Secretary Perez that underscores a number of the important points about access to investment advice and products such as making clear, as directed by Section 913 of Dodd-Frank, that the exclusive sale of proprietary products or services should not be viewed as a violation of any best-interest standards.

I wondered, again, Mr. Stevens, do you think limiting the scope of investments is in the best interest of the people saving for retirement?

Mr. STEVENS. No, I certainly do not. And I think we are in a marketplace where choice and competition are important as disciplines.

From where I sit, many aspects of this rule proposal are describing a marketplace that doesn't exist. If there were some massive failure in this market, you would not see mutual fund fees and expenses trending downward over 20 years as they have. You would not see the fees and expenses that people pay in 401(k) plans for mutual funds going down even further to represent, in fact, a universe of the lowest-priced funds available for investors in any jurisdiction in the world, something that is working in this market that I think has been overlooked.

Mr. HULTGREN. Yes. I appreciate that. A follow-up question, if the SEC moves forward with rulemaking under its authority in Section 913 of Dodd-Frank, do you think the broker-dealer industry will be faced with two burdensome and redundant sets of rules that sometimes conflict?

Mr. STEVENS. There is no question about that. In fact, if you think about the ecosystem for advice here, you have the retirement tax-advantaged accounts that we are talking about through DOL. You actually have a somewhat larger universe of retail assets. And for many people, they are bringing to the same advisor or broker needs in both areas.

And so in any rational policy universe, you would have a consistent regime proving appropriate protections to be sure that would apply to each.

Mr. HULTGREN. My time has expired. Thank you all for being here, again. We have to fight to protect families and help them save for retirement.

I yield back.

Chairman DUFFY. The gentleman's time has expired.

And I would just note again, you all on the panel can't see behind you, but there is a clock that we can see as the time runs down from 5 minutes to zero, then it starts to count backwards. And I have tried to allow the panel time to finish up their comments, but when we get near 40 seconds, I am starting to gavel you down. That has been my loose-gavel policy today to the whole panel.

Mr. BULLARD. I apologize, Mr. Chairman.

Chairman DUFFY. But just so you know, when it turns red the time has expired and please finish up your comments.

With that, the Chair now recognizes the gentleman from Colorado, Mr. Perlmutter, for 5 minutes.

Mr. PERLMUTTER. Thanks, Mr. Chairman.

First, I would like to say thank you to the panel.

I want to make a quick statement and then, Professor Bullard, let you finish your answer. And then I am going to yield my time to my friend, the gentlelady from Missouri, because I am sympathetic with her position, and I am sympathetic with the desire to have the SEC address this.

But I have been waiting for 4 years for the SEC to address this and they haven't. So the train has left the station. And people need to understand that.

I sent a letter to the Secretary of Labor and he did return my call. Last night, we talked for 20 minutes. We talked about the way this forces a change in business models on some companies and some industries. Exactly when do you present the contract to be retained, in effect? We went over a number of things.

And I would urge interested parties to continue to reach out to the Department of Labor. I do think that they are listening, and I am happy to make that phone call with my friend from Missouri to the Secretary.

So that is the first thing I would like to say, because he was not invited to participate in this panel despite his apparent desire to do so.

So Professor, if you would take 1 minute to finish your answer, so then I can give the balance of my time to the gentlelady from Missouri, whom I sympathize with, and I have co-sponsored her bill in the past. That train has left the station. But I want her to finish her questions.

Mr. BULLARD. I was at the end of my comment when I was cut off.

Mr. PERLMUTTER. All right.

Mr. BULLARD. And I agree. Representative Wagner has been more committed to this issue than probably anyone in Congress, so I would be happy to give her more time, too.

But your point about the SEC, I think maybe everyone in the room agrees on this. We all would have been better off if it had dealt with this issue when DOL proposed a rule in 2010, which, as you know, I opposed.

Mr. PERLMUTTER. Okay, it is 5 years, not 4 years.

Mr. BULLARD. Five years. And it is not just that. They have made proposals repeatedly that deal with exactly the same compensation practices that bothers the Department and they have done nothing. And I wish that they had addressed this issue and the Department probably would not be where it is now. But the SEC has failed to do so.

Mr. PERLMUTTER. All right.

Mr. Chairman, I would like to yield the balance of my time to the gentlelady from Missouri.

Mrs. WAGNER. I thank the gentleman very, very much.

And I would like to direct this question to Mr. Stolz. Representative Ellison, I thought, brought up a point and said that advisors can still talk to clients before signing a contract. But I understand this proposal greatly limits "investor education." And could you please elaborate on the effects of this provision of the rule?

Mr. STOLZ. Sure, I would be happy to. The contract has to come in place as soon as they move from education to recommendations. And the big question on the table is, where is that line drawn?

Mrs. WAGNER. Correct.

Mr. STOLZ. And we would love to see it drawn on the side of education, because clearly clients need way more education than they have. Right now, it looks like it is way too close on the recommendation side where I could get to a point as soon as I start saying, well, it looks like you should be 60/40, 60 percent equities, 40 percent, I am now making a recommendation. And before I do that, I have to give you this contract to sign. And I am literally going to stop the conversation and say, all right, next, please sign this, and then I will talk to you some more.

Mrs. WAGNER. Given the faulty economic analysis with the DOL rule and it is beyond fuzzy math is all I can say for them to have taken $1.7 trillion in the entire value of mutual funds and annuities in 2013 and say that savers lose about 1 percent based on some academic literature that they don't even reference and is not found I any kind of study is beyond fuzzy math.

But given this analysis with the DOL rule, is the additional analysis required of the SEC under the Retail Investor Protection Act appropriate?

Mr. Stevens?

Mr. STEVENS. There should not be any agency rulemaking in this area that is not predicated upon sound economic analysis. The Department of Labor's proposal is not. Any SEC proposal certainly should be.

Mrs. WAGNER. I have said over and over again it is a solution in search of a problem.

I probably don't have enough time to get into a couple of other areas that I have, so I will yield my time back to the gentleman, Mr. Perlmutter, and again, I am always in search of more time, so I thank you and yield back.

Mr. PERLMUTTER. I yield back the balance of my time.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. I thank the gentleman, Mr. Chairman, for the time to be able to be here.

My colleague and I from Colorado agree on a couple of things on this issue in support of the legislation that Mrs. Wagner is putting forward.

I do have a question, Mr. Stevens, if you would maybe address this and it is regards to with DOL, just the amount of experience that they have in terms of regulating securities, putting forward these rules compared to the SEC, is there a big difference?

Mr. STEVENS. The Labor Department's focus is on a slice of this universe. The SEC's is more comprehensive; it is certainly longer established and they work with the SRO in this area and its rulemaking, as well.

I would say, without intending to slight the Department of Labor at all, that there is deeper expertise at the SEC on these issues. And that having been said, I would agree with colleagues here they should have been to this ball more quickly.

Mr. TIPTON. And I would agree with that, along with my colleague from Colorado, to be able to get to it more quickly. But do you see a disturbing trend? We see it across-the-board, particularly as we see the expansiveness of Dodd-Frank implications, that we are seeing a broadening net of overlapping regulatory bodies moving into the space of investments.

Mr. STEVENS. What I worry is about a dynamic that demonizes an entire profession and an entire marketplace. We certainly have abuses in this market and they need to be rooted out. I think everyone should agree, we certainly do, that the clients' best interests needs to come first and we need appropriate standards in place that are rigorously enforced for that purpose.

But as we look at the market at large and as we think about certainly our part of it, the mutual fund part of it, there is a lot that is working very, very well for ordinary Americans trying to save for retirement.

So we need to size the problem, and we need to devise solutions that are appropriate to the problem, not demonize one and all associated with it.

Mr. TIPTON. I would agree with that.

Ms. McNeely, in your experience—we had heard the professor talk about risky stock funds versus safe bond funds putting in. When you are working with your clients, is one of the first questions you ask, what is your risk tolerance? Is that a standard for the industry?

Ms. MCNEELY. Absolutely. And not just the risk tolerance, but everything about them. We spend a significant amount of time gathering facts and data specifically about their situation. And I think the risk that we run, any regulation that causes us to use a one-size-fits-all simply based on product fees or product type is a mistake, because truly the only thing that we should be concerned about is what is in the best interest of the client.

And if the best interest of the client is to use a broad approach and use multiple different products, I think that is what we need to continue to push for.

And so, my experience has not ever been that I choose a mutual fund based upon the amount of money I get paid. I choose a group of mutual funds based upon what is right for the client.

Mr. TIPTON. And Mr. Stolz, maybe you would like to speak. I think that you had talked about some of the complexity, the liability, the expense that is going to be associated. And again, I will go to the professor's example of that risky stock fund versus the safe bond fund.

We have a 25-year old who starts making investments, putting it in, and we go with that safe bond fund, and then 20 years down the road, 30 years down the road, we compare that return to that risky stock fund which will more than likely outperform if statistics tend to hold.

Would you have a lawsuit that 20-year old now 50 could file saying you did not work on my behalf to be able to get the highest, best-potential yield for me?

Mr. STOLZ. Very potentially true you could, because you would look at it after the fact and say you should have known that I as a younger individual should have been able to have a higher risk

tolerance and, therefore, I should have been more heavily weighted into equities and, therefore, you put me too much into bonds, I was not able to accumulate enough money for retirement, and now I have a problem.

"Risk" is a relative term. And don't confuse risk with volatility. Clearly, in the long run, equities will return more than bond funds do. And so you have to take that in consideration.

Mr. TIPTON. Ms. McNeely, your experience professionally representing and caring about your clients, do you take that into consideration as a client moves through their years to be able to make those sort of recommendations to look at for them?

Ms. MCNEELY. Without question. And I would say that I think it is extremely important that they have an advisor. As they move through the years, we meet on a regular basis, in particular as they get closer to retirement. Their needs change, their scope changes. And the transition from the accumulation phase to the distribution phase is such a critical transition. And if you don't have an advisor moving you along the spectrum and potentially moving you from different products as you make that switch, you could make some real missteps.

Mr. TIPTON. Thank you.

I thank the panel for being here.

And I yield back, Mr. Chairman.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Let me just say first off, coming from my background, the first thing I realize is that most Americans are not financial experts. And millions are often not even financially literate. And I think that becomes part of the problem that we are trying to get folks to become more financially literate. And so therefore, they must make some decisions that are complex financial products and try to steer them to what we want them to do, to be able to plan for retirement and choose from what is seemingly an infinite number of products. And it is hard for them to navigate what those products are.

So on the one hand we need to make sure that Americans continue to have access to financial education on their retirement products and options, and thereby have access to financial professionals.

And on the other hand, because these average Americans are vulnerable, we need to protect them from people who are just trying to sell them products so that they can make themselves more money.

So we have to make sure that we have a balancing act here.

As a result, for me, this DOL fiduciary rule is far too important and we must absolutely strike the right balance between access to financial services and consumer protection. I think if you tip the scale one way or the other we could try to do one thing and hurt the other. And we can't do it. We have to make sure that this is really a balanced situation.

I looked at what took place and what happened recently in the U.K. And in the U.K., we saw how their new proposed rule or fidu-

ciary rules greatly diminished access. I have to make sure that does not happen.

So with that and some of the stuff that we are going back and forth, maybe I will address this question to Mr. Stevens. Some of the alternatives proposed by industry stakeholders claim to establish a more "workable fiduciary duty." Can you please elaborate on what is workable and what is not workable under this DOL proposal?

Mr. STEVENS. Thank you, Congressman. We actually in our comment letters have outlined a whole series of things that we think could be done to the DOL proposal to make it workable, to make it a sensible regime that would serve investors effectively.

You start with the need to draw a clear common-sense line between the provision of fiduciary advice on the one hand and information and education on the other, because there is a huge need among all sorts of people for information and education and help which is short of the fiduciary advice and the relationship of trust and confidence that implies.

And we need to have a line between them. The one is held up to a very high standard, the highest under the law, the other ought to be encouraged if we are going to get that balance correct, as you had said.

We need, in this BIC exemption, this best-interest-contract exemption, to do all sorts of things. Secretary Perez has said we need to take a principles-based approach to this. We would agree with that. But when we look at that exemption, it is anything but a principle-based approach. It is more like an Internal Revenue Code of all sorts of compliance requirements.

We need to avoid retroactive application of any new rule, too, because of the huge disruption it has for existing relationships. That, it seems to me, is very sensible. As I have said before, we need a meaningful, orderly implementation period.

So we go into greater detail in each of these in our comments, but those are some ideas about how to make this a workable proposal.

Mr. MEEKS. Thank you.

Mr. Bullard, in your testimony you stated that many of the alternatives put forth by the industry do not address conflicted compensation arrangements. Can you discuss what some of those conflicted compensation arrangements are?

Mr. BULLARD. Some of the arrangements are the ones that I have outlined where, for example, rather than it being an issue of how you should allocate among funds, the question that I would like Ms. McNeely and Mr. Stolz to answer is, should you get paid more for selling a stock fund than a short-term bond fund? That is the straightforward question. There is no rational basis for paying somebody more for recommending one over the other. And I don't think they would defend that.

I also think it is extremely abusive to have what I view as ratcheted payout grids where simply by making a very small additional sale you can literally go from choosing between an $80 commission to a $29,000 commission.

And I mentioned this probably going over more than an hour ago, so no one has answered the question here as to whether they

think it is appropriate to be paid twice as much for selling stock funds over short-term bond funds, or to have a choice between $80 and $29,000.

And lots of broker-dealers, to their credit, have decided it is not appropriate and they have already put in place procedures to deal with those conflicts.

And the DOL, they are trying to deal with those kinds of conflicts and they have been left unaddressed by FINRA and the SEC for decades.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Maine, Mr. Poliquin, for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman. I appreciate it very much.

And thank you all very much for being here today. This is such an important issue.

When I was in the pension management business 30 years ago, the business was so much different than it is today. Look at the different products that our investors have to choose from. And the costs have plummeted. And so markets go up, markets go down, but our broker-dealers and our financial advisors are always there to help our middle-class families who are trying to make it through this recession and save for their kids' college savings or their retirement.

I don't worry about our workers at Bath Iron Works, which is part of General Dynamics, abutting my district, the Maine 2nd District. I don't worry about the folks at L.L. Bean. These are big companies and they have access to the best investment advice that you could possibly want.

What I worry about are the small-business owners in our district in Down East Maine, the fellow who pulls traps and is one of the best lobster men you could ever find in Down East Maine and provides a product that we all want, we all enjoy. If you haven't been to Maine, fall is a great time to go there.

And I worry about those people. They are struggling through the worst recession we have had in 70 years. They are trying to put aside a little bit of money so they can retire on it. And they know deep down in their hearts somewhere, somehow, the government is not going to be there for them.

Let's face it, Social Security is a $15 trillion unfunded defined benefit pension plan. So we should have a government here, all of us, that helps our small investors, a government that works for them, not against them.

And so I really worry about that. We had a fellow coming in our office, a fellow by the name of Doug Curtis from Edward Jones down in Rockland, which is midcoast Maine. And he has a book of business of maybe 200 clients. And they are small investors just starting out and they are trying to make sure they have enough money to augment what they hope will be Social Security down the road.

But he comes in and he says, "Bruce, if this rule goes through in its current form, costs are going to go up, the product offerings are going to go down, the rates of return are going to go down for

my clients, and I am not going to be able to offer them advice at all."

So here is my question. If you are a great logger or a trucker or you are working in a paper mill or you are a nurse or a teacher, you know your business really well, but you don't know the financial services business very well, as Mr. Meeks said. So do you put your money in stocks or in bonds or in cash? Do you buy annuities? What about the asset allocation? What about my age? How much should go in stocks, how much should go in bonds? What if I have a home mortgage, what if I paid it off? What if I have a second kid going to college, what if I don't?

Who is going to provide this advice if the FAs and the broker-dealers do not?

I am really worried about them. And I think that we ought to make sure that any rule that is passed is one that helps our small investors and not hurts them.

So I frankly think that this is a classic example of big, intrusive government trying to create regulations that are not needed.

Everything is based on trust in your industry, right? If your clients don't trust you, they are not going to hire you. They are certainly not going to trust you with their money. So that in itself is a very positive development in this industry, especially with all the competition out there.

So Ms. McNeely, I would like to ask you a question. I get a little bit concerned when I hear about, well, if this goes through and all of a sudden the advice that we could give to the folks saving for their retirement is going to dry up and now you are going to have to rely on robo-advice.

Now, can you imagine? My mother is 87, my dad is 85 and I love them to death. And they have a little bit of money saved aside. My parents don't log on, they barely can use a cellphone. So how is mom at 87 going to get robo-advice on maybe a mutual fund that she has and maybe she would have fixed-income investment, at her age maybe she will be in cash? But she is not getting anything in cash, so what does she do?

So tell me, Ms. McNeely, in real life what that would look like?

Ms. MCNEELY. They might actually come to you for advice. I hope you are prepared for that.

Mr. POLIQUIN. I am not. I never give advice to my parents, but they give it to me all the time.

[laughter]

I will say that you have described exactly what my biggest concerns are. Those individuals are the very people who need our advice. And when you went through your list of all the questions that need to be asked and taken into consideration before you make any recommendations to your client, we do that each and every day with our clients back in Spencer, Wisconsin.

So I will wholeheartedly agree with your concern. And I will also tell you that it would be extremely detrimental if your parents were not able to get the advice that they need at that time in their life.

Thank you all very much. Keep pushing, let us get this right. It is a great thing we are trying to do. We have to make sure we get it right.

Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Delaware, Mr. Carney, for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman. Thank you for holding this hearing.

And I thank all of the the panelists for being here today.

I can't believe we are still talking about this issue, frankly. When I first came here in 2011 this was a big issue, a complicated issue for me, and we are still talking about it nearly 5 years later.

In the small State where I come from, we would put all the people who had interest and knowledge about an interest like this, put them in a room, form a task force, get them to work together, and come up with a proposal that works best for everybody.

This process that we have is beyond me. I don't think we should, with all due respect to my colleague from Missouri, kick the can down the road anymore. We need to come up with a solution.

I hear some common themes here that it seems like people on both sides of the issue could agree around to get something where we can move forward.

When I talked to the Secretary of Labor on this issue sometime ago when he presented to a group of us, he indicated that he was interested in giving the small investor a tax cut, if you will, or a reduction in fees and so that, in some ways, is an objective of his.

I share the concerns that Mr. Lynch articulated sometime ago about the effect of this rule, where we are headed on the small investors. I think Mr. Stevens mentioned that there are 20 million accounts out there of $25,000 or less.

So let me focus my questions on those people.

What do you expect will happen if this rule goes into effect, Mr. Stevens, Ms. McNeely, to those investors in those accounts? What is the worst-case scenario? And what are the potential unintended consequences for that?

And then, Mr. Bullard, I will give you an opportunity to give your view of that.

Because I think a lot of where you come down on this issue is what your expectation is about what is going to happen after it goes into effect. And a lot of that, in my view, is speculation.

Mr. Stevens?

Mr. STEVENS. It will decisively affect business models of firms across the country who are trying to serve small investors.

Mr. CARNEY. How so?

Mr. STEVENS. It is going to increase costs, it is going to increase liability. It will involve massive changes in the way they have to interact with their clients if we can negotiate this rule.

Mr. CARNEY. Does that mean it won't be cost-effective for those clients to be served? Is that what you are saying?

Mr. STEVENS. You might incur substantially increased costs of doing business, but you would expect to be doing it on a fee basis for larger accounts because you will get more money. And so the idea of servicing a $25,000 account or a $10,000 account on 1 or 1/2 percent in light of the new requirements of the rule, it is just not economical.

Mr. CARNEY. So they will be left without, that is what I have heard.

Mr. STEVENS. That is our fear. That is exactly right.

Mr. CARNEY. Ms. McNeely?

Ms. MCNEELY. I would concur with that statement and also let you know that we included a chart in our written comments that basically talks exactly about that person that you are discussing, a small saver putting away an amount of money on a monthly or an annual basis. And if they choose a current model, a commission-based model right now and we are forced to look at a fee-based model as a requirement of potentially getting moved to a different model, they would probably have to pay about double the amount that they would currently be paying if they stayed in that commission-based model.

So my concern is that we may not be able to continue to serve those individuals. And if we could serve them, it would be at a much higher cost to them.

Mr. CARNEY. Professor Bullard, your view of that?

Mr. BULLARD. I am getting paid by hedge funds to tell them what the effect of the rule is going to be, so I have been into the guts of the rule, and none of my analysis assumes that the people are moving to asset-based fees.

Mr. CARNEY. So what is your assumption? My time is running out.

Mr. BULLARD. So my assumption is, well, first, what is going to happen is you are going to see a flattening of compensation across the short-term bond fund and the stock fund. That is inevitable, that will be at the financial advisor level. But the DOL is not affecting branch manager compensation at all, which I think is a problem. But it definitely does not affect the broker-dealer level where nothing will be changed.

Another effect is going to be, under the current proposal, there is going to be a big shift of the people who are selling non-traded REITs to fixed indexed annuities, which is unfortunate because fixed indexed annuities are not even subject to the securities laws, and I hope that they will change that in their final proposal.

Another change is you are going to see some shift in asset allocations. They are going to become a little more conservative, because at the margins it is inevitable that there are some recommendations that are probably a little more aggressive than they would be if you had flat compensation. So statistically that will happen, but we don't really know exactly what the magnitude is going to be.

And then in the revenue-sharing space, that is where it is going to be fairly complicated because revenue sharing varies a lot. Even within broker-dealers, they have different revenue-sharing arrangements with different complexes. What will happen is, because revenue sharing trickles down to financial advisors—

Mr. CARNEY. Okay, I have to stop you there because I have 8 seconds.

Thank you all for your participation. This has been a complicated and frankly frustrating exercise for somebody who comes from a State where my constituents expect us to get things done.

Thank you, Mr. Chairman. I yield back.

Chairman DUFFY. The gentleman yields back.

Without objection, members of the full Financial Services Committee who are not members of either subcommittee may participate in today's hearing.

The Chair now recognizes the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman. Thanks for having this hearing. I appreciate the time and I appreciate what I have heard today. I come at this hearing from the fact that for 35 years I have been in this business, both as an investment manager on the fiduciary side running a bank trust Department, being a CEO of a FINRA-registered broker-dealer, and so I have a lot of opinions, as you can imagine, on this topic.

But I want to make some general comments first, and that is we should be encouraging savings in this country through public policy, and not have a war on savings like proposals that we have had in the past to do away with 529 plans that were beaten back, or to raise capital gains taxes, or to punish people who have saved their whole life and tax away their IRA benefit if it is over a certain amount.

Fifty percent of Americans in this country don't have a will, 41 percent of Americans over 55 years old don't have a will. And more time should be devoted to planning. And I think we all know in the financial services industry that people spend more time planning their vacation than they do planning for retirement and saving every year.

And so we should be supporting, as Mr. Meeks talked about, financial literacy. And one way we do that is consultative relationships between the financial advisory community and the client community. And anything that gets in the way of that conversation or tries to put it in a box is a bad idea.

And my view is that the DOL should, at the very least at this moment, re-propose this rule based on the additional comments.

Further, Secretary Lew and Director Donovan at the OMB, in my view, should carefully look at this rule. Is this in the interest of government efficiency, government accountability?

And as my colleague Mr. Carney said, this has been working along for 5 years. It is absolutely not the way to run anything and it is an embarrassment to our country that we can't come together the way Dodd-Frank suggested, which was to have the SEC study this issue and put it out, put it out. And instead, we are trying to skip steps here and run around on the other side of the field and go through the DOL for retirement accounts.

So to me, it is an example, it is a classic of Phil Howard, the famous New York lawyer, who wrote a book called, "The Rule of Nobody." This is more—we have robo-rulemaking now, much less robo-investing, and that is not the way. We want managers to do their job by their clients and to adopt suitability standards and adopt fair-dealing standards and do things the right way.

So I am distressed that this has taken this long. And I call on the SEC to do their job here and not waste people's time for another 5 years on this project.

I would like to yield the balance of my time to my distinguished colleague, the gentlewoman from St. Louis.

Mrs. WAGNER. Thank you. I thank the gentleman from Arkansas for his consideration and for the time here.

I wrote and introduced the Retail Investor Protection Act, the second Congress that I have put this forward because I care deeply about the retail investor, especially the low- and middle-income investor.

I also care deeply about just about everyone that you all represent, which is an industry. And I am absolutely disgusted at the fact that we have an Administration that has villainized and disparaged an entire industry and even in public forum called them snake oil salesmen.

My broker-dealers, my financial advisors, they are friends. They were there when my first baby was born. They were there when we baptized that child, when we put them in school, when we married that child. To villainize an entire industry is absolutely wrong.

And I have to put that out there and say also that I love stories and I would love to have the time to tell a story about a Missourian in Blue Springs, Missouri, a story about a financial advisor who describes this married couple 15 years ago who were in their late 40s and 50s, IRAs of about $10,000 conservatively invested. After providing financial advice to the couple, they now have over $100,000 in the account and the client is debt free, including the mortgage.

Mr. Stolz, if DOL's fiduciary rule were final and effective today, would this married couple be able to receive the same financial advice that they did? In 2 seconds.

Mr. STOLZ. In 2 seconds, no.

Mrs. WAGNER. All right. I have more about this family. To be continued.

I yield back my zero time.

Mr. FITZPATRICK [presiding]. The Chair recognizes the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. I thank the gentleman. I will move very quickly because I want to hear the end of the story.

Mr. Stolz, it is already against the law for me to churn an account, isn't it?

Mr. STOLZ. That would be correct.

Mr. MULVANEY. It is already against the law for me to put somebody in an unsuitable account, isn't it?

Mr. STOLZ. That would also be correct.

Mr. MULVANEY. It is already against the law for me to lie to somebody about the funds in an IRA, isn't it?

Mr. STOLZ. Yes.

Mr. MULVANEY. So all the horror stories we have heard today that we are trying to fix are already against the law, aren't they?

Mr. STOLZ. Yes.

Mr. MULVANEY. Yes.

Mr. Bullard, you have mentioned twice, I think, in your testimony that if you spend more on something, you get more of something. I happen to believe that is true. There are a couple of corollaries to that, which is if you spend less, you get less, and if you spend none, you get nothing.

And my fear is what we are moving to is a circumstance where some people are not going to get any advice at all and other people

are going to get really, really lousy advice. And I am glad to hear that there is some bipartisan pushback on moving down that road.

The last thing I want to read is an article, very briefly, from 2014. The head of the Department of Labor's Employee Benefit Security Administration gave an interview and she talked about the advantages of regulation versus legislation. And I will read it very quickly.

"Back in the day when people wanted to make changes they passed legislation. And when a major bill like ERISA was passed there was always the opportunity to come back and make some technical corrections. Today you can't get Congress to pass a Mother's Day resolution."

This is Phyllis Borzi.

"So what we have done is we have shifted from the way that social change and legal change and financial change is accomplished through congressional action to two different avenues for making changes, the main one being regulation. One advantage of regulation is that the agencies writing the rules are able to receive input from the public, something that doesn't often happen with Congress."

The irony of getting a letter from the Department of Labor on their position before—

Mrs. WAGNER. Three days before.

Mr. MULVANEY. —the input was received, in light of that comment from the same Department, is not lost on us.

With that, I will yield my remaining 3 minutes to my good friend from Missouri.

Mrs. WAGNER. Thank you. I appreciate that very, very much.

Mr. Stevens, regarding my story about the Blue Springs couple I described earlier, there clearly were some benefits to having access to financial advice. Does the Labor Department's economic analysis incorporate those benefits at all, sir?

Mr. STEVENS. I think the analysis is incorrect in important ways, Congresswoman. One is that if that couple or whomever has to go to a fee-based account, which is what we are talking about—

Mrs. WAGNER. Correct.

Mr. STEVENS. —migrating in that direction, that seems to be what the Labor Department's intent is, they are going to be incurring fees and as a substantial percentage year-on-year of what their account is.

The Labor Department didn't consider any of those costs in coming up with their regulatory impact analysis.

Mrs. WAGNER. Does the Department of Labor factor in the costs of not having access, this is exactly what my next point is, to the financial advice in regard to retirement savings? That has not been put in the equation at all and I believe you just did elaborate.

Mr. STEVENS. And that is a somewhat different point. But to the extent that people don't have access to advice after the new rule is adopted, the likelihood is that they are going to make some bad investment decisions that will be costly to them. We actually estimate that is in the tens of billions of dollars.

So if you add all of these things up, these new costs, it is about $109 billion in new costs to American investors and savers.

Mrs. WAGNER. A hundred-and-nine-billion dollars in new costs—

Mr. STEVENS. That is correct.

Mrs. WAGNER. —with them not having access to financial advice with regard to their retirement savings.

Mr. STEVENS. Or paying fees that they hadn't been paying before.

Mrs. WAGNER. Mr. Callahan, considering the extent that unintended consequences could result from this rule and the faulty economic analysis supporting the rule, how important is the Retail Investor Protection Act in preserving low- and middle-income access to financial advice?

Mr. CALLAHAN. It is critically important. And let me clarify a point. Congressman Carney asked Professor Bullard about what will happen to lower-income investors and he speculated about a number of things.

I am not going to speculate; I am going to tell you what we have already done. We have met off-site as a firm. In light of this rule, we will form a separate business to serve IRAs and we will make the minimum of that somewhere between $100,000 and $250,000. That is what we are doing, not a speculation.

The other point I would make—

Mrs. WAGNER. That is the answer I am looking for. Could you elaborate? You have the rest of my time, sir, 40 seconds.

Mr. CALLAHAN. The other point I would make is that I have heard about this perceived tradeoff between access and protection, and I don't believe that those are mutually exclusive. The whole idea that the choice is either this best-interest standard or nothing is a false choice.

And Congressman Mulvaney made a great point in that the existing regulatory framework, the horror stories we hear, most of them are breaking existing law.

I work under a best-interest standard with the SEC, I work under FINRA, and I can tell you on a day-to-day basis taking money and putting it into investments, the FINRA regime is far more rigorous.

And I will leave you with one final question, and that is this. We are going to go to bed at night and think that this fiduciary standard is going to solve all the problems. There is not a world void of conflict and bad people will break the rule. And let me ask you, which regime was Bernie Madoff under when he stole money? The best-interest regime.

Mrs. WAGNER. I thank you all very, very much.

Mr. FITZPATRICK. The Chair recognizes the gentleman from Indiana, Mr. Messer, for 5 minutes.

Mr. MESSER. Thank you, Mr. Chairman.

I was raised by a working person, a single-parent mom, who just retired from the Delta faucet factory. I represent a district full of working people, the kind of investors who would be impacted by this law.

And I am reminded of an adage in life: we are not just responsible for our intentions; we are responsible for our results. And as much as I respect the broker-dealers and all those who work within the industry, my concerns with this rule are, of course, related to that industry, but they are more importantly related to the individual investors and what the results of this could be for the working people who need this retirement to get to the finish line.

And this Administration, often the policies that they are putting forward end up hurting the very people that they are designed to help.

And so I wanted to explore with you a little bit, Mr. Callahan, Mr. Stevens, and Ms. McNeely, the Obama Administration has a stated priority of promoting policies that would make guaranteed lifetime-income products more widely available to help middle-class Americans save for retirement.

Do you believe that this fiduciary rule standard that they are putting forward will make that more likely to happen for middle-class families or less likely?

Mr. CALLAHAN. As I said in my opening testimony, it will make it less likely. Those products are prohibited.

I will give you an example. Treasury has talked about the importance of using lifetime-income annuities. We have been through volatile markets in 2008 and 2009. We have had a good run until a few weeks ago. People forget what it is like to see their account values go extremely up and extremely down.

But what is interesting is that the Treasury issued final regulations last year on qualified longevity annuity contracts that were designed to put these lifetime-income annuities inside retirement plans, and yet this rule, on the face of it, would prohibit the very use of the products the Treasury just finalized the rule encouraging them to use 12 months ago.

And that is a perfect example to me of why it absolutely is not encouraging; it is actually prohibiting.

Mr. MESSER. Mr. Stevens, Ms. McNeely?

Mr. STEVENS. Just very briefly, one of our recommendations is that if we do have this BIC exemption that it be expanded in its scope to include a whole range of products as opposed to the kind of legal list that the Department of Labor has come up with.

Ms. MCNEELY. I would also just echo what has already been said, but also just to add that Mr. Ellison discussed the fact that pensions are really not much in existence any longer. And really, there are three things that provide guaranteed income stream that are available to any American. The first is pensions, which are going away; the second is Social Security, which has some issues; and the third is an annuity that can provide a guaranteed income stream.

And the lower- and middle-income consumers are definitely the ones who are going to be best served to look at an annuity so that they can at the very least provide a guaranteed income stream to cover their basic living expenses.

Mr. MESSER. And again, under the theme you are not accountable only for your intentions, also for your results. All financial products are not the same, they offer different options, guarantees, benefits for consumers to choose based on their individual needs. For example, products like annuities have higher fees due to the guarantees they provide to consumers.

Will the rule limit a consumer's choice in access to these products? Will it skew the market towards certain products based solely on fees, regardless of the overall benefit to the consumer?

Mr. STOLZ. I will take that one if that is okay.

Mr. MESSER. Yes. Yes, Mr. Stolz, sure.

Mr. STOLZ. There is no question that one of the criticisms of annuities in general, and we heard it in Secretary Perez's stories, is that they are costly. They come with guarantees, as you have said, that are important and those cost something.

There will be a bias against any investment that has appeared to be costly, and by nature that is going to mean advisors are going to be less likely to recommend products like that.

Mr. MESSER. Who will be hurt most by that?

Mr. STOLZ. Clearly, the individuals who need that lifetime income. Nobody wakes up in the morning and says, hey, I have to go buy lifetime income today. They need to talk to an advisor who is going to say based on your current situation, here is how to solve that problem. And anything that gets in the way of that is going to be a problem for those individuals.

Mr. MESSER. Mr. Callahan?

Mr. CALLAHAN. Yes, I would just add the fact that we are even talking about a BIC exemption implies that it is prohibited from the beginning, and that is the idea of bringing this framework to IRAs.

The SEC, in its fiduciary standard, you can do what is in the best interest, but bringing this other framework over has the prohibited transactions, one is self-dealing. And at face value the fact that you will be paid a commission for giving advice would make that prohibited, and then you need to use this door of an exemption to get there.

And as we have testified, that exemption is unworkable. So by the very nature of the rule the way that it is written, it prohibits the use.

Mr. MESSER. In my limited time, I would just say we all want to see low-income and retail investors do well in this market. We want to see them protected. The reason we are concerned about this rule is it may give them less protection than they have in the current marketplace.

I yield back the balance of my time.

Mr. FITZPATRICK. The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

I have heard from constituents throughout my district in central and eastern Kentucky time and again that this rule will negatively affect them, they are very concerned about the fact that employers would not be able to bring in financial advisors to provide kind of basic educational information to their employees, including not-for-profit organizations.

Investors with small accounts will not be able to receive advice for 401(k) plans. No simple rollovers will be accessible. Middle-class investors are losing access to professional advice. More and more Americans will be forced to seek information on the Internet.

And to me, when the Secretary of Labor says that robo-calls can fill the gap, are we serious about that? Do we really think that replacing flesh-and-blood advisors with robo-calls and Siri as a stock picker on your iPhone is really a better outcome with this rule? Is that really investor protection? That is the rhetorical question.

Let me share with you four stories from my constituents and then have you react to them, about what they think this rule would preclude.

The first example is a retired sheriff's deputy who made $38,000 a year for most of his professional life. He had a 403 plan that was rolled over into an IRA, into diversified mutual funds. He watches the market, he calls his broker once a year, maybe twice a year about the asset allocation. He calls his stockbroker and he gets a tip and he says, should I move all of my diversified portfolio into this single grocery store stock market because my neighbor said this is a really hot tip? Thirty-eight-thousand dollars a year, rollover into an IRA.

Obviously, the stockbroker prevented that kind of a misallocation of his retirement resources. And what the investment advisor or what the stockbroker told me is that he would no longer be able to serve that individual. That would have been a disaster for that retired sheriff's deputy.

Another one. A working-class guy, very fiscally responsible, saved money every single year, and said I am going to retire when I have a million dollars in savings. Not a big income, but over the course of a fiscally responsible, financially responsible, working lifetime, he gets that million dollars. But because he has a lot of dependents, he needs a guarantee. So he goes to his stockbroker and he says I need a guarantee, I need an annuity. And he paid for the annuity, but he was satisfied because he needed that guarantee.

The investment advisor, the stockbroker says to me if this rule goes into effect I would no longer be able to serve that client.

Third example. Not-for-profit company, not-for-profit organization has a retirement plan, the proposed DOL rule would preclude the advisor from going in and providing individual investment advice for the employees of a very vanilla retirement plan for those not-for-profit employees.

And finally, a fourth example. In rural Kentucky, a factory worker who goes into a stockbroker's office for free advice, basically gets free advice on the asset allocation of his retirement plan, in the anticipation that one day there will be a rollover. That kind of free advice based on accountability would no longer exist under this proposed DOL rule.

In the minute remaining, comment on these vignettes and whether or not you agree that under the proposed DOL fiduciary proposal, you wouldn't have these scenarios where retail investors would have access to basic services where the rule would hurt the very people it is supposed to protect?

And keep in mind, as we hear Professor Bullard talk about the cost of investment advice under current law being high, what my constituents are telling me is that if you think the cost is high now for professional advice, wait until you see the cost of amateur advice or no advice.

Feel free to comment on that.

Mr. CALLAHAN. I would agree. And I would comment that Professor Bullard's analysis doesn't represent the funds that we use or the marketplace that we work in.

But to your point on the stories, I would have to know more facts about each of them, but in general, yes, I would agree that will be the consequence, they will lose advice.

And it goes back to the brilliance of Congresswoman Wagner's bill on requiring analysis, when you are quantifying what the problem is you are trying to solve you can build a better solution. We have proposed to the SEC those 408(b)(2)-like disclosures that put on one piece of paper what are you doing, what are you getting, what does it cost you.

And I would say if you had two funds and on one piece of paper one was twice as expensive as the other one and the services that you were going to receive for that were the same, people are smart and they would look at that and say, wow, in a simple, one-page document I can see that versus thousands and thousands of pages on a website that they will never read.

And make it practical, make it actionable, make it preventative, not how do we rig this thing to unwind it in the future.

Mr. FITZPATRICK. The gentleman's time has expired.

The Chair recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Again, I would like to thank the witnesses for appearing today.

And I especially am grateful that, Mr. Bullard, you decided to come knowing that you would be outnumbered, understanding, however, that the rules permit this to take place, not because there are not others who would agree with your position who are experts, but because of the rules that we have here at the House.

So I do understand some of the exasperation that you may experience. But notwithstanding this, I understand also that you are here because you care about small investors, and you care about small businesses. You care about them because you don't want them to make investments that are based upon a need or a desire by the advisor to put himself ahead of the investor, the people who are in need of good advice.

So let us go back to the question that you wanted everyone to answer. Would you pose your question again, and that is the question of the $80 I believe versus $29,000?

Mr. BULLARD. It is whether it is appropriate to get paid more for recommending, for example, a stock fund or short-term bond fund, more than twice as much, or in some cases have to choose between an $80 payment or a $29,000 payment if you are on the brink of reaching one of those bonus-triggering payout grids.

Mr. GREEN. My assumption is that all of you have understood this question. He has reiterated it several times. So let us just start with the person who is to my far left and ask, do you believe that the person that Mr. Bullard has referenced should be put in a position where he can get $80 versus $29,000? And I am going to ask for a simple yes or no. If you cannot answer yes or no, just simply say you pass.

Mr. CALLAHAN. I pass.

Mr. GREEN. Thank you.

Let us move to the next person.

Mr. STEVENS. I am not sure I understand the question, and so I can't answer yes or no.

Mr. GREEN. Let us do this, then. I have a few seconds left.

Mr. Bullard, explain the question one more time please.

Mr. STEVENS. Could I just ask what I don't understand? Mr. Bullard is talking about the compensation arrangements within a broker-dealer with respect to its own people. Is that correct?

Mr. BULLARD. Yes, it is a trickle down from what they are paid by the fund.

Mr. STEVENS. Okay. My own personal view, this is not an investment company institute policy issue, so I would agree—

Mr. GREEN. I take it you will pass since you cannot answer yes or no, and I will go to the next person.

Ms. MCNEELY. I would need more than one word, so I guess I will pass.

Mr. GREEN. You will pass, yes.

Mr. STOLZ. I will say no because Mr. Bullard has said on numerous occasions that we have already fixed that at Raymond James.

Mr. GREEN. You have fixed it at Raymond James, but you do agree that we have not fixed it industry-wide. Is that a fair statement?

Mr. STOLZ. I am going to limit my comments solely to Raymond James and our position.

Mr. GREEN. I understand. So you have no knowledge of what is happening industry-wide.

Mr. STOLZ. I didn't say I didn't have any knowledge of what is happening industry-wide, but I am not familiar with the compensation structures.

Mr. GREEN. Is it fair to say then that you are not going to answer because you are concerned about the response you might get from the rest of the industry?

Mr. STOLZ. I am simply not familiar with the compensation arrangements of the other broker-dealers.

Mr. GREEN. I see. All right, well you have done well.

Let us go back to Mr. Bullard. Mr. Bullard, you see what we are dealing with. Not all advisors are bad. But we do want those that are to know that they have a fiduciary responsibility and that they should put their clients above themselves. That is simply what this is all about, requiring investment advisors to put their clients first, not themselves.

And my suspicion is that most Americans within the sound of my voice believe that is a pretty good idea to put the clients first.

Mr. Bullard, what will happen if they don't put the clients first? Because we have had many people to talk about what happens if the rule goes into effect, what happens if we continue to allow them to not put the clients first?

Mr. BULLARD. There are two things that would happen. One is at the margins you will consistently have products that are sold that are not in the best interests of the client, and that will have a marginal, incremental, negative effect on all of those people.

And then the other category will be some people will have devastating consequences. And Mr. Stolz used the example of the Toffels and defended the sale of that product. I looked up what that product was and this is the Prudential sheet that shows that was an L Series class of variable annuities. And this is one of the largest sellers of the annuities deciding it is getting out of the business

because they are inherently abusive given the kinds of riders and the length of period for redemption.

And this is an article that cites FINRA that specifically cited those L share series as being a target of their reviews. So that is an example that it is anecdotal, it doesn't really tell you much about the industry. But that was a case where, if you are a financial advisor and you could not have anticipated that an elderly person might get ill and that was unexpected, that is malpractice. You have to expect that an elderly person might get ill and need the liquidity that a variable annuity wouldn't provide.

Mr. FITZPATRICK. The gentleman's time has expired.

Mr. GREEN. Mr. Chairman, if I may, I have a statement that I would like to enter into the record, if there are no objections.

Mr. FITZPATRICK. The statements will be admitted under general leave at the conclusion of the hearing.

Mr. GREEN. I shall wait. Thank you, Mr. Chairman.

Mr. FITZPATRICK. The Chair now recognizes himself for 5 minutes, and I am going to yield my time to the sponsor of the Retail Investor Protection Act, the gentlewoman from Missouri, Mrs. Wagner.

Mrs. WAGNER. I can't thank my colleagues enough for their 3- to 4-years' indulgence in my absolute passion on this issue, all those in industry and, most importantly, that retail investor, that low- and moderate-income investor who is every member of my family, every person in my cul-de-sac, every person with whom I go to church. They will be impacted by this.

And yes, every single investor and saver for retirement deserves the best—the best—information, the best advice that they need.

And I would remind the ranking member and others that there are rules and regulations currently already on the books that are dealing with many of these issues, problems and faults. But to put in another thousand pages of rules and regulations that does not harmonize with the SEC, that stands to run in different paths of the SEC is just simply wrong.

Secretary Perez and the Department of Labor have framed this proposed rule as simply requiring advisors to work in a client's best interest. And if advisors are already doing this, then there should not be any problems, he says.

Is this an accurate statement? And if not, can you please explain why the marketplace reality is much more complex?

Mr. Callahan?

Mr. CALLAHAN. It is far more complex and goes to the point of this false choice, that the choice is this regulation or nothing. And even Professor Bullard testified FINRA took action under the existing regulatory framework—

Mrs. WAGNER. Correct.

Mr. CALLAHAN. —to correct something in the marketplace, a schedule that was approved and filed with the SEC, just to be clear. The advisors didn't make up these products. They are filed and in practice the rulemaking framework worked. FINRA came in and corrected the measure, as he testified.

So it is far more complicated than that. And to think that our only choice is this standard as drafted by the Department, which pre-defines what is best and what is not best and takes some solu-

tions off the table because they are prohibited and then begins to try to work them back in with exemptions, to me is so clear that it is a square peg in a round hole and far more complicated than the light touch that the Department claims that it is.

Mrs. WAGNER. Mr. Stevens?

Mr. STEVENS. If it were quite that simple it wouldn't have required hundreds of pages in the Federal Register.

Mrs. WAGNER. Correct. As I said, every investor deserves the best information they need. I care deeply about the retail investor and the low- and moderate-income investor. I care deeply about an industry that I think is full of good actors that help families save and invest for their retirement and for their future.

Congress has already provided the avenue in Dodd-Frank to look at issues between different standards of care under Section 913. That analysis and rulemaking is being done by the SEC, which is the regulator that is familiar with current securities law and has a much better understanding of the stakeholders and the market.

SEC Chair Mary Jo White hasn't directly criticized Secretary Perez, but this spring she said the SEC is working on its own rule. Commissioner Gallagher, a Republican on the SEC, says in a letter to Mr. Perez that the rule currently as proposed and as not willing to be re-proposed or changed in any way, shape or form, as my correspondence has demonstrated here, says that it is clear that the DOL rulemaking is a fait accompli and the comment process is merely perfunctory.

This rulemaking from the Department of Labor makes their inexperience in this area crystal clear. And this hearing has, I think, today showcased and further demonstrated the proper avenue for further regulation, which is the Retail Investor Protection Act.

I thank you all for your indulgence.

I thank the Chair and so many of my colleagues for yielding their time. And we will fight on. Thank you.

I yield back.

Mr. FITZPATRICK. The gentlelady yields back.

I would like to thank the witnesses for their testimony here today.

Mr. Green?

Mr. GREEN. Yes, thank you, Mr. Chairman. I would like to submit without objection a statement from the Honorable Ranking Member of the Capital Markets Subcommittee, Carolyn Maloney. And without objection, I shall submit it.

Mr. FITZPATRICK. Without objection, it is so ordered.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is adjourned.

[Whereupon, at 12:35 p.m., the hearing was adjourned.]

A P P E N D I X

September 10, 2015

Representative Andy Barr (KY-06) Statement for the Record
September 10, 2015
"Preserving Retirement Security and Investment Choices for All Americans"

"Mr. Chairman, thank you for calling this hearing and for this opportunity to weigh in on the Department of Labor's (DOL) April 14, 2015 proposed rule (RIN 1210-AB32) that would greatly expand the regulatory definition of a "fiduciary" under the Employee Retirement Income Security Act (ERISA). This rule will significantly change how millions of Americans seek help to make their investment decisions and the relationships that they have with their financial advisor, and I am very concerned that this rule will make it more difficult for hardworking Americans to save for retirement.

I have heard from constituents throughout my district time and again that this rule will negatively affect them. Employers will not be able to bring in financial advisors to provide educational information to their employees. Investors with small accounts will not be able to receive advice for their 401K plans. Middle-class investors will lose access to professional advice and more and more Americans will be forced to seek information on the internet.

On July 29, 2015, Representatives Ann Wagner, David Scott, Lacy Clay, and I sent a bipartisan letter to Secretary Perez stating our belief that the DOL should adequately review and consider all relevant comments received in order to ensure that unintended disruptive changes do not impact the delivery of financial advice to investors in the retirement savings market by issuing a re-proposal of this rule.

Secretary Perez replied and stated that the DOL would not entertain this request.

I agree that financial advisors should act in the best interest of their clients. Heightened consumer protections in the investment space should apply broadly and should not create two classes of investors, especially at the expense of those saving for retirement. The current proposal would bi-furcate the industry into those who can afford an advisor and those who cannot. The result will be less choice for consumers and a lack of access for retail investors to sound financial advice.

Additionally, the rule should not impose further burdens on middle class Americans and unnecessarily disrupt existing relationships that they have developed with their financial advisors. It is important that Americans saving for retirement have access to quality information and advice, and Federal regulation should not hinder those striving to save for retirement.

Recent events in the United Kingdom, where low dollar investors have lost access to advice from financial advisors, present a case study of what can happen if this rule is not implemented correctly. The rule in its current form could have a disparate impact on access, choice, and costs for millions of low- and middle-income Americans saving for their retirement.

I would like to thank Representative Wagner for her leadership on this issue, and I would like to thank the Chairman for holding this hearing. I hope that this committee will continue to stand up for the millions of hardworking Americans who will be negatively affected by this expensive, harmful rule that will disproportionately impact small and retail investors."

Opening Statement of Congresswoman Carolyn Maloney
Cap Markets/O&I Subcommittee Hearing on DOL Fiduciary Duty Rule
September 10, 2015

The Department of Labor's fiduciary duty rule advances a very simple principle — if you are giving investment advice to retirement savers, and you are being compensated for your advice, then you have to put your customers' interests first.

This much-needed update of the rules governing investment advice to retirement savers will plug some key holes in our regulatory regime.

When the Labor Department first wrote the rules governing who is a fiduciary back in 1975, Individual Retirement Accounts, or "IRAs," barely even existed. So under the 1975 rule, advisers to individuals who were saving for retirement through IRAs were not subject to a fiduciary duty.

Now — 40 years later — more than 40 million Americans have IRAs, which together hold more than $7 trillion in assets.

DOL's proposed rule would plug this hole, by making advisers to individual IRA owners fiduciaries, and requiring them to put their customers' interests first.

That said, this proposed rule is not perfect, by any means. There are definitely changes that need to be made before the rule is finalized, and even though I support the principle underlying the rule, I have been urging DOL to make some necessary changes as well.

For instance, the rule subjects advisers to IRAs to a fiduciary duty by requiring them to enter into a so-called "Best Interest Contract" with their customers — but does this mean that advisers have to get potential customers to sign on the dotted line as soon as they walk in the door, and before they ever speak?

Surely there is a less cumbersome way to ensure that advisers are subject to an enforceable fiduciary duty — perhaps requiring a quick, one-sided representation from the adviser that she is a fiduciary at the beginning of a conversation.

In addition, I'm not sure all of the disclosures that the DOL requires as part of the Best Interest Contract are truly necessary or effective — and in some cases I think they will actually be *counterproductive*. Requiring advisers to disclose 1-, 5-, and 10-year projections for each fund option that they are presenting to retirement investors will likely lead to investors choosing the riskier fund all-too-often, since those projections will show the riskier funds having higher returns.

So I think we should identify problems like these, and then work constructively with DOL to find solutions.

In fact, I sent a letter to Secretary Perez last week asking for some changes and clarifications to the rule that I believe will make it better.

But I think we should be pragmatic about the rule — if there are other changes that are necessary before the rule is finalized, then let's talk about solutions to those problems too.

Thank you.

Statement of the Honorable Kyrsten Sinema

I appreciate the opportunity to comment on the Department of Labor's proposed rule, redefining who is a "fiduciary" of an individual retirement plan or employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA).

While I strongly support the Department's goal to ensure financial advisors act in the best interests of their clients, I remain concerned about the multiple unanswered questions related to the proposed rule and the potential impact a rule would have on the affordability and accessibility of financial information for investors.

For example, I am concerned by the potential impact the proposed rule would have on consumers' access to important retirement education information. I encourage the Department to protect access to educational information and not unintentionally restrict the types of investment education available to consumers saving for retirement.

In order to have a successfully implemented rule, it is vital that the proposal doesn't limit consumer choice and access to advice, have a disproportionate impact on lower- or middle-income communities, or raise the costs of saving for retirement. The retirement savings gap for all Americans is a staggering $14 trillion and one-in-five Americans approaching retirement age has zero retirement savings. Now is not the time to reduce access to important investment tools.

Closing this gap should be the underlying purpose of DOL's actions, and protecting access to investment information will help Americans responsibly save for retirement. I urge the Department to seek a balanced approach to both protect consumers and maintain affordable access to retirement investment advice for all Americans.

Testimony of Mercer E. Bullard
President and Founder, Fund Democracy, Inc.
and
MDLA Distinguished Lecturer and Professor of Law
University of Mississippi School of Law

before the

Subcommittees on
Capital Markets and Government Sponsored Enterprises,
and Oversight and Investigations

Committee on Financial Services

United States House of Representatives

Preserving Retirement Security and Investment Choices for All Americans

September 10, 2015

Chairman Garrett, Ranking Member Maloney, Chairman Duffy, Ranking Member Green, members of the Subcommittee, it is an honor and a privilege to appear before the Subcommittee today. Thank you for this opportunity. I am the Founder and President of Fund Democracy, a nonprofit advocacy group for investors, and a Professor of Law at the University of Mississippi School of Law. This testimony discusses H.R. 1090 in Part I and the Department of Labor's proposed exemption from prohibited transaction rules for Individual Retirement Accounts ("IRAs") in Parts II - IV.

In summary, I do not support H.R. 1090. As discussed in Part I.A, Section 2 would prevent the Department from completing its long overdue rulemaking by making that rulemaking contingent on prior, unrelated rulemaking by the Securities and Exchange Commission ("SEC" or "Commission") under Section 913 of the Dodd-Frank Act. Investors would continue to experience losses resulting from financial advisers' incentives to make recommendations that are not in investors' best interest, with no guarantee that the Commission would *ever* adopt rules under Section 913. As explained in Part IB, it is unreasonable to make any rulemaking contingent on SEC action in view of the SEC's longstanding rulemaking paralysis. Section 3 of H.R. 1090 would require unnecessary, redundant and burdensome reports and analysis by the Commission and would be inconsistent with APA principles of notice and comment, as I discuss in Part I.C.

I strongly support the Department's proposal and urge Congress to take proactive steps to help the Department finalize its rulemaking. The Department's proposal to treat financial advisers who make investment recommendations to investors as fiduciaries will help protect investors from abusive sales practices and conflicted compensation arrangements. Fiduciary status will cause broker-dealers and financial advisers to violate certain prohibited transaction rules as a result of conflicted compensation arrangements that make the amount of an adviser's compensation depend on the recommendation made by the adviser. However, the Department has proposed exemptions from the prohibited transaction rules that are both workable for the industry and effective in protecting investors.

The adverse effect of conflicted compensation arrangements is indisputable. Just as it is a fundamental law of economics that if you tax an activity you will get less of it, it is a fundamental law of economics that if you pay for more certain recommendations, you will get more of them. For example, if you pay your financial advisers more for selling stock funds than short-term funds, which is standard industry practice, more stock funds will be sold than if advisers' compensation was the same for both funds. I discuss the pervasive effect of conflicted compensation arrangements in Part II.

The financial services industry claims that the Department's proposal cannot work. In fact, the proposal is eminently workable. Industry claims are based on erroneous assumptions regarding how the proposal would operate in practice. Part III of this testimony corrects the most common misperceptions regarding the proposal. Industry claims are also belied by the fact that some broker-dealers have been able to implement workable compensation practices that comply with or even exceed the requirements of the Department's proposal. For example, some broker-dealers have already mitigated conflicted compensation arrangements by: (1) eliminating financial advisers' differential compensation for platform and proprietary funds, (2) capping commission compensation for financial advisers, (3) adopting product-neutral commissions and payout grids, (4) abjuring production-based payout grids altogether, and (5) limiting payout increases to prospective sales rather than also applying them retroactively. These and other current practices are both workable for broker-dealers and beneficial for investors. In Part IV, this testimony discusses certain alternatives to the Department's proposals that have been offered by industry members.

I. H.R. 1090

A. Section 2 of H.R. 1090

Section 2 of H.R. 1090 prohibits the Department from completing its rulemaking until at least 60 days after the Commission has issued a final rule pursuant to Section 913 of the Dodd-Frank Act. I do not support Section 2 for a number of reasons.

- Conduct standards under the securities laws are lower than under ERISA. In ERISA, Congress expressly decided to impose higher standards of care and loyalty with respect to retirement assets than it imposed under the federal securities laws. Section 2 therefore conflicts with ERISA because it prevents the Department from imposing the higher standards that ERISA requires in deference to an agency that does not have the authority to impose such standards.

- The securities laws regulate only securities, whereas ERISA covers all types of retirement assets. In ERISA, Congress expressly decided to regulate assets that are not securities and therefore not subject to the federal securities laws. Section 2 therefore conflicts with ERISA because it prevents the Department from regulating non-securities in deference to an agency that does not have the authority to regulate non-securities.

- In ERISA, Congress specifically granted the Department authority over the regulation of retirement assets, including non-securities assets. The Commission does not have authority over the regulation of non-securities or authority over many types of retirement plans. Section 2 prevents the Department from exercising the authority Congress specifically required it to exercise in deference to an agency that does not have this authority.

- The Department has not adopted any rules, it has only proposed rules. The Department has made it clear that it will makes changes to its proposal. Congress should not prevent the Department from adopting rules when it does not know what rules the Department may adopt. Section 2 broadly threatens the functioning of regulatory agencies and the principle of notice and comment by judging, in effect, final rules without knowing what the final rules will be. It undermines the rule of law by interfering with the very process of administrative rulemaking.

If Congress disagrees with the positions taken by the Department in its proposals, there are reasonable means for it to do so. It could, once there is actually a rule with which it can disagree, amend ERISA to change the legal standards that apply to retirement assets or narrow the scope of those legal standards.

Section 2 is also inappropriate because it requires the Department to wait for an agency to adopt rules when the agency clearly will not do so. As discussed further below, the Commission has repeatedly acknowledged the problems that the Department's proposal addresses but chosen not to address them. Indeed, with respect to discretionary rulemaking the Commission has exhibited regulatory paralysis for more than a decade. It is unreasonable to condition the Department's rulemaking on other rulemaking that will

not happen in the foreseeable future. In this case, rulemaking delayed would be rulemaking denied.

B. Commission's Rulemaking Paralysis

The Commission has proposed a number of rules, none of which it has been able to finalize, that address issues that provide much of the impetus for the Department's rulemaking. In doing so, the Commission has demonstrated that it cannot be relied to take action under Section 913 of the Dodd-Frank Act or otherwise adopt rules to require adequate disclosure of conflicted compensation arrangements or to require procedures designed to eliminate or mitigate the adverse effect of these arrangements.

i. Revenue Sharing Payments

Since the 1990s, mutual fund companies have made distribution payments out of their management fees, yet there are no Commission rules that require disclosure of these payments, much less rules that address the conflicts of interest that differential revenue sharing payments create. Revenue sharing payments generally comprise a percentage of the transaction amount and an ongoing percentage of fund assets held at the broker-dealer. Industry participants have been sued by private parties, state securities regulators and the Commission itself regarding inadequate disclosure of revenue sharing arrangements, yet the Commission has been unable to set of clear standards for revenue sharing disclosure.

The Commission proposed rules to address this issue in 2004 that would have mandated disclosure to investors at the time of the transaction ("point of sale").[1] It was unable to finalize this rulemaking. In 2010, the Department put the Commission on notice that it intended to regulate revenue sharing with respect to retirement assets. Also in 2010, the Dodd-Frank Act amended the Exchange Act to require the Commission to:

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[1] Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Rel. No. IC-26341 (Jan. 29, 2004). *See also* Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds, Rel. No. IC-26778 (Feb. 28, 2005) (requesting additional comments).

> examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers.[2]

Despite such patent invitations for the Commission to take action, the Commission has failed to promulgate rules. More than a decade after its point-of–sale proposal, the Commission has been unable to take final action on that rulemaking. It continues to regulate revenue sharing primarily through its enforcement program.

ii. 12b-1 Fees

The Commission has conceded for more than 15 years that Rule 12b-1 was in dire need of reform. For example, the mutual fund confirmation shows the amount of the commission charged, but it does not show the 12b-1 fees that investors pay on an ongoing basis. This misleading omission has been exacerbated by the broker-dealer industry's shift, over the last two decades, from commissions to asset-based fees. Commissions on mutual funds have steadily declined, while 12b-1 fees have increased and become the functional equivalent of a deferred or installment commission.

In 2008, SEC Chairman Christopher Cox promised that,

> in coming days, you can look for the SEC to open up the hood of this old jalopy and start cleaning out the gunk. When the overhaul is done, I predict there won't be a 12b-1 in there anymore.[3]

The "coming days" became months, which became years. In 2010, the Commission finally proposed substantial reforms to 12b-1 fees,[4] yet it has unable to take final action

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[2] Dodd-Frank Act Section 913(g) (adding new subparagraph (l) to Exchange Act Section 15).

[3] Comments by Christopher Cox, Chairman, U.S. Securities and Exchange Commission, at the Investment Company Institute 4th Annual Mutual Fund Leadership Dinner, Washington, D.C. (Apr. 30, 2008) ("Chairman Cox Comments") *available at* http://www.sec.gov/news/speech/2008/spch043008cc.htm.

[4] *See* Mutual Fund Distribution Fees; Confirmations, Rel. No. IC-29367 at 15 – 16 (July 21, 2010) ("12b-1 Fee Proposal").

on that rulemaking. Seven years after Chairman Cox's promise, and five years after proposing reforms, the SEC's "pending repeal or reform of rule 12b-1"[5] is still pending.

iii. Mutual Fund Fixed Pricing

Section 22(d) of the Investment Company Act requires that mutual funds sell their shares at the price stated in the prospectus. The effect of this requirement is to fix the commissions charged for purchasing shares of a given mutual fund, regardless of whether the broker-dealer responsible for the transaction would charge less for its services. Thus, one reason that broker-dealers are paid differential commissions is that they cannot choose the commission level at which they wish to provide their services.

As the Commission has noted, Section 22(d) "effectively prohibits competition in sales loads on mutual fund shares at the retail level;" such anticompetitive price fixing "would normally be a violation of the antitrust laws."[6] In 2010, the Commission proposed to allow funds to sell shares for which broker-dealers determined the commission.[7] However, as has been the case with a number of initiatives, the Commission has been unable to close the deal.

iv. Fiduciary Duty

Section 913 of the Dodd-Frank Act specifically authorizes the Commission to adopt rules that apply a fiduciary duty when broker-dealers provide personalized investment advice. Congress provided specific guidance regarding its intention that such rulemaking not prevent commission-based compensation or the sale of proprietary products while also expressing specific concern regarding:

> the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers,

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[5] Chairman Cox Comments, *supra.*

[6] 12b-1 Fee Proposal, *supra,* at 87 & n.266 (citing *U.S. v. National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 701 (1975) (antitrust immunity is afforded to sales made pursuant to Section 22(d))).

[7] *Id., passim.*

including any material conflicts of interest.[8]

The SEC Chairman had promised to engage in such a fiduciary rulemaking even before the Section 913 was enacted, but more than five years after Section 913 became law no action has been taken.

v. Conclusion

These examples reflect a pattern of acknowledging the problems that the Department now seeks to address but failing to take action to address them, as well as a broader regulatory paralysis exhibited by the Commission over last fifteen years. For example, when the Commission exempted certain broker-dealers from registration under the Advisers Act, it was unable to adopt a final rule until forced to do so by litigation years later. In the 1990s, after the Commission permitted exchange-traded funds ("ETFs") on the condition that they fully disclose their portfolios, and after issuing a concept release on actively managed ETFs in 2001,[9] it took 14 years to permit the offering of a managed ETF that did not disclose its portfolio.

In 2003, the Commission proposed a rule that codified the terms of hundreds of multi-manager exemptions, but no final action has been taken.[10] Nor has the Commission adopted proposed Rule 6c-11, which was proposed seven years ago and would codify ETF exemptions.[11] Both multi-manager fund and ETF sponsors therefore still must obtain individual exemptions. Giving new meaning to the word "temporary," the Commission adopted a "temporary" exemption from principal trading provision of the

[8] Dodd-Frank Act Section 913(g) (adding new subparagraph (l) to Exchange Act Section 15).

[9] *See* Actively Managed Exchange Traded Funds, Rel. No. IC-25258 (Nov. 8, 2001). In 2015, the Commission requested comment on ETFs and other exchange-traded products. *See* Request for Comment on Exchange-Traded Products, Rel. No. 34-75165 (June 12, 2015).

[10] *See* Exemption from Shareholder Approval for Certain Subadvisory Contracts, Rel. No. IC-26230 (Oct. 23, 2003) *available at* https://www.sec.gov/rules/proposed/33-8312.htm.

[11] *See* Exchange-Traded Funds, Rel. No. IC-28193 (Mar. 11, 2008).

Advisers Act in 2007 with an expiration date of Dec. 31, 2009,[12] which it has extended in violation of the APA in 2009, 2010, 2012 and 2014.[13]

In the 1990s, the Commission became aware of widespread market timing based on stale mutual fund prices, but it did nothing to stop such abuses until forced to do so, in effect, by the New York Attorney General. Similarly, the Commission sat by while analysts' conflicts corrupted the investment banking industry until the New York Attorney General stepped in and forced major reforms. In 2007 and the first half of 2008, the growing short-term credit crisis provided obvious signals that money market funds ("MMFs") were at risk. Requests for no-action relief to bail out funds had reached an all-time high, and funds that were structurally similar to MMFs failed or experienced runs.[14] In January 2008, my advocacy group submitted a rulemaking petition with other advocacy organizations asking the Commission to reconsider its *ad hoc* no-action process and to require MMFs to file electronically their portfolios with the Commission to enable the systematic review of MMF pricing accuracy.[15] The Commission took no action, and the Primary Reserve Fund failed in September 2008.

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[12] *See* Advisers Act Rule 206(3)-3T; Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Rel. No. IA-2653 (Sep. 24, 2007).

[13] *See* Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Rel. Nos. IA-3948 (Dec. 17, 2014) (Dec. 31, 2016 expiration date), IA-3522 (Dec. 20, 2012) (Dec. 31, 2014 expiration date), IA-3128 (Dec. 28, 2010) (Dec. 31, 2012 expiration date) & IA-2965 (Dec. 23, 2009) (Dec. 31, 2010 expiration date).

[14] Financial Crisis Inquiry Report, National Commission on the Causes of the Financial Economic Crisis in the United States at 254 – 255 (January 2011)(at least 44 fund companies bought securities from their MMFs' portfolios in late 2007) *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. A $5 billion cash fund that was operated by GE similar to an MMF failed in late 2007, and a $27 billion state-run cash fund experienced a run in which $8 billion in assets were redeemed over a two week period. *See id.* at 255.

[15] *See generally* Letter from Fund Democracy, Consumer Federation of America, Consumer Action, AFL-CIO, Financial Planning Association, and National Association of Personal Financial Advisors to Nancy Morris, Secretary, U.S. Securities and Exchange Commission (Jan. 16, 2008) *available at* http://www.sec.gov/rules/petitions/2008/petn4-554.pdf.

In 2013, the Commission proposed investor protections in conjunction with adopting rules that permit issuers to advertise private offerings publicly.[16] When the Commission issued the proposal, Chair Mary Jo White stated that she was:

> firmly committed to keeping consideration of this proposal on track so that the Commission is able to make an appropriate and timely regulatory response to the operation of the new rule permitting general solicitation.[17]

Nonetheless, more than two years later the proposal is still pending.

In conclusion, it is *per se* unreasonable to make any regulatory action contingent on prior action by the Commission. Time and time again, the Commission has proposed rules and promised reforms but been unable to get the job done.

C. Section 3 of H.R. 1090

Section 3 of H.R. 1090 requires that, prior to promulgating a rule under Section 2, the Commission conduct a study of broker-dealer and investment adviser regulation. It requires that, "alongside" the promulgation of such a rule the Commission publish certain findings regarding harm to and confusion among investors. It also requires the Commission, in *proposing* such a rule, to consider the differences in the regulation of broker-dealers and investment advisers. In principle, I generally agree that the Commission should consider the factors identified in Section 3 pursuant to any fiduciary rulemaking. However, I am opposed to this provision for a number of reasons.

Section 3 is redundant because the Commission has previously committed to complying with Executive Order 13563, which would require the reviews and consider the factors that Section 3 mandates.[18] That Order requires that agencies:

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[16] Amendments to Regulation D, Form D and Rule 156, Rel. No. 33-9416 (July 10, 2013). The Commission also stated that it would "monitor and study the development of private fund advertising and undertake a review to determine whether any further action is necessary." Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Rel. No. 33-9415 at 51 – 52 (July 10, 2013).

[17] Statement of Mary Jo White, Chair, U.S. Securities and Exchange Commission (July 10, 2013) *available at* http://www.sec.gov/news/statement/2013-07-10-open-meeting-statement-mjw.html.

[18] *See Improving Regulation and Regulatory Review*, Executive Order 13563 (Jan. 18, 2001).

> (1) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify);
>
> (2) tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations;
>
> (3) select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity);
>
> (4) to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt; and
>
> (5) identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public.[19]

Section 3 will complicate the administrative process and increase regulatory burdens and costs without providing any benefits. I also oppose H.R. 1090 for the following reasons.

- The Commission has already conducted an exhaustive study of the broker-dealer and investment adviser regulatory regimes. The provisions of Section 913 already provide clear guidance and limits on the Commission's rulemaking authority regarding a fiduciary duty for broker-dealers, such as the requirement that rulemaking not impede commission-based arrangements or the sale of proprietary products. The Commission already has indicated in its prior report that it intends to extend any fiduciary rulemaking to reconsideration of broker-dealer and investment adviser examination requirements.

- Section 3 requires that the Commission satisfy certain requirements before it even issues a proposal, which means that critics may be able to challenge a proposal before it has become final. This requirement undermines the notice and comment process and the foundation of administrative law. If this provision is adopted, it should clarify that the APA does not apply.

- Section 3 exacerbates the problems created by Section 2 because it places additional, improper impediments to the Department's carrying out its statutory

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[19] *See id.*

duties by delaying further the Department's rulemaking. In other words, it requires that a different agency make certain findings that may not even be relevant to a Department rulemaking, yet the Department rulemaking could not occur unless such irrelevant findings are made.

- Section 3 improperly emphasizes investor "confusion." Whether investors have a clear understanding of the legal duties owed to them by financial advisers is not the issue that a fiduciary duty addresses. A fiduciary duty comprises a standard of care and a standard of loyalty. Broker-dealers routinely hold themselves out and provide investment advice as financial advisers, and the law has for centuries held such professionals to a fiduciary duty, regardless and independent of their clients' understanding of that duty.

- Section 3 would prevent the Commission from adopting rules unless it found that they reduce either "confusion or harm to investors . . . due to different standards of conduct" (the term "either" should be inserted in the provision for clarity). Harm to investors is not caused by different standards as such, it is caused by one or more standards being inadequate to protect investors. If a finding is required, it should be that the rule promulgated reduces harm or confusion.

II. Conflicted Compensation Arrangements

Over the last few decades, broker-dealers have developed a wide variety of compensation structures that incentivize financial advisers to make recommendations that pay them the highest compensation. The kinds and effects of conflicted compensation are truly mind-boggling. Differences in compensation often bear no relationship to the services provided. Instead, they seem to exist only to generate higher revenues for the minority of financial advisers who choose to serve investors by choosing to serve only themselves.

Broker-dealers are paid part of the commission paid on a mutual fund purchase, part of which is paid to the financial adviser. For example, on a $10,000 purchase of the American Mutual Fund, an investor would pay a 5.75% commission ($575), of which the funds' distributor would pay 5.00% ($500) to the selling broker-dealer (the "gross dealer concession," or "GDC"), which would generally pay its financial adviser from 20% ($100) to 100% ($500) of that amount. The payment to the financial adviser is typically based on a "payout grid" that pays the adviser a percentage of the GDC. A typical payout would be 40% ($200). I have assumed a 40% payout in the examples provided below.

If the investor were a 70-year-old retiree, it usually would not be appropriate to invest 100% of her $10,000 in a stock fund. However, the adviser would be paid less if part of the investment were placed in a bond fund or short-term bond fund. For example, if $5,000 of the $10,000 investment were invested in The Bond Fund of America, the commission would be only 3.75% ($187.50), the GDC only 3.00% ($150), and the financial adviser's payment only $60. If $5,000 were invested The Short-Term Bond Fund of America, the commission, GDC and adviser's payout would be, respectively, 2.50% ($125), 2.00% ($100) and $40. In other words, the financial adviser would be paid 40% less ($60) for selling the bond fund and 60% less ($40) for selling the Short-term bond fund.

These compensation differentials create a substantial economic incentive for a financial adviser to recommend more aggressive asset allocations to the 70-year-old retiree and other clients. The following table shows the commission/GDC/adviser payout for four different allocations. From the most to the least aggressive, the financial adviser's total compensation declines 35%. Extrapolating to an annual salary, the adviser must choose between income of $100,000 or $65,000, or an income of $200,000 or $130,000. These distorted incentives are understated, however, because the combined effect of other types of compensation differentials can be far more extreme.

	100%/0%/0% Allocation	80%/20%/0% Allocation	50%/30%/20% Allocation	30%/35%/35% Allocation
Commission	$575	$530	$443	$383
Gross Dealer Commission	$500	$460	$380	$325
Adviser Payout	$200	$184	$152	$130

To illustrate, consider the same investor making an investment of $35,000 instead of $10,000. Now the adviser has an additional conflict because some complexes offer discounts on commission at certain investment levels, known as "breakpoints." For example, The American Fund provides a breakpoint at $25,000, at which point the commission on the entire investment drops from 5.75% to 5.00%, which would mean less compensation for the broker-dealer and the financial adviser. The financial adviser therefore has an incentive either to spread the investment among different complexes so as to fall under the $25,000 breakpoint, or simply to avoid funds with $25,000

breakpoints. This would not be difficult. Breakpoints at $50,000 are quite common; they can be as high as $500,000.

The financial adviser also has an incentive to recommend funds that pay higher commissions. The American Fund's 5.75% commission is typical, but many stock funds charge a 5.00% commission or less.[20] The Cavanal U.S. Large Cap Equity Fund charges a 3.50% commission and pays a 3.25% GDC. Simply choosing The American Fund over the Cavanal Fund for a $10,000 investment would *alone* increase the financial adviser's compensation by 54% (from $130 to $200).

The financial adviser also has an incentive to recommend funds that pay a higher GDC. For example, the DWS Capital Growth Fund charges a typical 5.75% commission, but shares 5.20% with broker-dealers rather than the more common 5.00%. On a $10,000 investment, the extra 0.20% would generate $20 more for the broker-dealer and $8 more for the financial adviser. This might not seem like much, but DWS believes that this additional payment will help increase sales. Over billions of dollars in annual fund sales, these incentives add up.

In summary, financial advisers can more than double their compensation by opting for a more aggressive allocation to stock funds that have high commissions, high GDCs, and low breakpoints. The financial adviser's compensation varies substantially where the time invested and level of analysis provided does not vary at all. The financial adviser's time and effort spent on choosing an asset allocation and fund complex is the same regardless of what allocation or complex is ultimately recommended. It is economically irrational for the adviser to be paid more to recommend an aggressive asset allocation over a conservative one, or for recommending one fund complex over another. The industry complains that the Department's proposal will adversely affect small investors. In fact, the industry's conflicted compensation causes the greatest harm to small investors

[20] The average commissions for stock and bond funds are 5.4% and 3.8%, respectively. *See* ICI 2015 Investment Company Fact Book at Figure 5.8. *Cf.* Robert Litan and Hal Singer, *Obama's Big Idea for Small Savers: 'Robo' Financial Advice*, Wall. St. J. (July 21, 2015) (claiming that "small savers [pay] ***something like a 2% sales charge*** (or commission) up front when buying mutual funds." (emphasis added)).

because they are most likely to purchase the shares that create the greatest conflicts. Small investors will benefit from the proposal more than other investors.

The financial industry claims that removing such conflicted compensation structures would not be workable. However, some broker-dealers have *already* done so. For example, some have introduced "fee capping" whereby they limit the maximum commission that a financial adviser can receive on the sale, for example, of an emerging markets equity fund at 4%.[21] In other words, we know that eliminating incentives to provide bad advice is workable because it is already working. The Department's proposal is intended to bring about precisely this kind of reform.

Differential commissions represent only one way that financial advisers' recommendations are improperly conflicted. Financial advisers may also receive different levels of 12b-1 fees depending on the fund complex selected. They receive different financial benefits as a result of choosing fund complexes that pay higher revenue sharing than other complexes. The potential doubling of compensation described above grows larger as one type of improper financial incentive is stacked on another.

One of the most egregious forms of compensation incentives is the ratcheted payout grid. As financial advisers generate more GDCs, their payout percentage rises. For example, at $300,000 of GDCs over the preceding 12 months, an adviser's payout percentage might increase from 32% to 42% of GDCs, as is the case, for example, for a Janney Montgomery Scott payout grid.[22] However, this increase does not apply only to the

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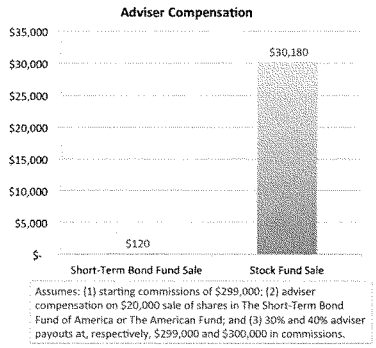
[21] *See* Report on Conflicts of Interest, FINRA at 30 (October 2013) ("Report on Conflicts of Interest") ("In the context of mutual fund and variable annuity sales, an effective practice FINRA observed is firms' use of "fee-capping" to reduce incentives for a registered representative to favor one product family over another for comparable products. In a fee-capping arrangement, a firm caps the GDC that can be credited to a registered representative's grid. Any GDC in excess of the cap accrues to the firm. For example, a firm may cap at 4 percent the GDC for emerging market equity funds. This would eliminate incentives for a registered representative to favor a mutual fund that paid a higher GDC than the 4 percent. It would not, however, eliminate the potential incentive for the registered representative to recommend a fund with a 4 percent as opposed to a 2.5 percent GDC.") *available at* http://www.finra.org/sites/default/files/Industry/p359971.pdf.

[22] The Janney Montgomery Scott payout grid appears at page 7 of my written submission to the Department at http://www.dol.gov/ebsa/pdf/1210-AB32-2-WrittenTestimony28.pdf. For a general discussion of the structure of payout grids, *see* Report on Conflicts of Interest, *supra*, at 27 – 28.

GDCs at $300,000 and above. Rather, the 10 percentage point increase in the payout *also* applies to the previous $299,000 in GDCs. This ratcheted compensation structure means that a financial adviser has an additional incentive of $29,000 (10% of the first $299,000 in GDCs) to recommend that his next sale generate enough commissions to get to $300,000 for the preceding 12 months. In other words, how the adviser recommends that a $20,000 investment be allocated will determine whether the adviser is paid an additional $29,000. ***As shown in the chart below, an effective commission of 2.00% for the financial adviser (40% of the 5.00% GDC) on a $20,000 investment in a stock fund is turned into an effective commission in excess of 150% of the amount invested. Will the adviser sell the short-term bond fund and be paid $120? Or will he sell the stock fund and be paid $30,180?*** It is truly remarkable that the Commission and FINRA allow broker-dealers to offer such financial incentives for their financial advisers.[23]



Indeed, this example illustrates where the Department's position is far too tame. The Department suggests that, under its proposal, broker-dealers consider "effective policies and procedures relating to an Adviser's compensation for broker-dealers," including "[a]voiding creating compensation thresholds that enable an Adviser to increase his or her compensation disproportionately through an incremental increase in sales." Ratcheted payout grids such as the one applied by Janney Montgomery Scott should be

[23] While FINRA has noted such extreme incentives, but it has not prohibited them or, to my knowledge, taken any enforcement action regarding them. *See* Report on Conflicts of Interest, *supra*, at 28 - 29 ("Some firms apply a broker's payout percentage on a retroactive basis. . . . In the context of compensation grids, paying a registered representative a higher percentage of gross revenue may legitimately reward effective and hard workers and encourage higher productivity. A conflict is created, however, if a representative's desire to move to a higher payout level influences the number or type of recommendations he makes to customers. This conflict may be heightened when there is a relatively large increase in the percentage payout between revenue tranches; when there is a high probability that a few, incremental sales will move a registered representative to a new payout level; or where increased payout percentages are applied retroactively once a threshold is satisfied."). Nor were these extreme financial incentives mentioned in FINRA's most recent 2015 Regulatory and Examination Priorities Letter dated January 1, 2015. *Available at http://www.finra.org/industry/2015-exam-priorities-letter#1.*

per se prohibited. While that firm and others would likely complain that eliminating such structures would not be "workable," this claim would beg the question as to how some broker-dealers find it workable to use payout grids *that are not based on production at all.*[24]

III. The Department's Proposals are Eminently Workable and Already Working

The Department's has proposed rules that are, notwithstanding claims by industry, eminently workable. Industry sophists claim that they cannot comply with the rules while also receiving commissions and that they will be forced, as a result, to require investors to enter into asset-based fee arrangements. However, these claims are not supported by the facts or the actual terms of the Department's proposal.

The industry is correct that, under the Department's proposal, a financial adviser's investment recommendation made to a retail investor regarding retirement assets will trigger fiduciary status, as it should, which would render a subsequent transaction a violation of the prohibited transaction rules if the financial adviser could receive differential compensation in connection with the recommendation (*e.g.*, higher compensation for a transaction in one available product than another). There is nothing unusual about fiduciary status triggering prohibited transaction rules. There are many instances in which common business practices run afoul of ERISA's prohibited transaction rules, but the Department has adopted exemptions from these rules, subject to certain conditions, that have been quite workable and made ERISA a workable statute.

For example, a retirement plan administrator that is a plan fiduciary cannot be paid fees by the plan and also receive 12b-1 fees from mutual funds that are investments options in the plan. However, the Department has taken the position investments in 12b-1 fee funds are permitted provided that the plan fiduciary offsets the fee it receives from the plan by

[24] *See* Report on Conflicts of Interest, *supra*, at 28 ("Several firms with which FINRA met do not use a grid structure based on production. Some of these firms base payout percentages on a registered representative's years of service.").

the amount of the 12b-1 fees it receives from the funds.[25] This exemption is relevant here because it involves precisely the kind of fee leveling that firms that service plans have found workable for years, yet these same firms now claim that fee leveling in the retail context cannot work.

Rather than explain exactly how complying with the Department's proposal would actually affect their business practices, industry participants have generally adopted a strategy of insisting that the Department's proposal would put them out of business. The industry makes generalized assertions that the Department's standards are impossible to understand or comply with, when in fact their operation is self-evident and compliance requirements are clear. What is truly not "workable" *for investors* is paying financial advisers more for recommending one transaction than another when there is no reason to receive higher compensation other than to receive higher compensation. This is economically irrational and, as a policy matter, indefensible. The effect is an annual net social cost in the billions, a huge, wasteful transfer of wealth from uninformed, unsophisticated investors to deeply conflicted financial advisers.

Rather than acknowledging the blatant compensation conflicts discussed above and proposing *effective* alternatives to eliminating or mitigating them, the financial services industry has generally followed a public strategy of misrepresenting the operation and effect of the Department's proposal. Many of the same practices that the industry claims are not "workable" have been adopted (and made workable) by broker-dealers. The following discussion identifies and rebuts many of the baseless claims that have been made regarding the Department's proposal and provides examples of practices deemed not "workable" that some broker-dealers have nonetheless already adopted.

- ***Broker-dealers could receive compensation only if the compensation is level for all possible recommended transactions.*** The Department's proposal would require fee leveling only for fees paid to the financial adviser, and even then in limited circumstances. It would not require any change in compensation received

[25] *See* PTE 77-4 (April 8, 1977); DOL Advisory Opinion 93-13A (April 27, 1993); PTE 98-25 (June 9, 1998). *See also* EBSA Press Release (Aug. 23, 2012) (settling charges against ERISA fiduciary adviser for receiving 12b-1 fees and revenue sharing payments) *available at* http://www.dol.gov/opa/media/press/ebsa/EBSA20121753.htm.

at the firm level. Nor would it require any change in compensation paid at the branch manager level if the branch manager does not make recommendations to clients.

- ***Broker-dealers and financial advisers would be required to sell the lowest cost product and would be prohibited from selling the highest cost product.*** The relative cost of different products is irrelevant to the Department's proposal, which goes to financial advisers' financial incentives to sell products and the compensation they receive, not the cost of products to investors.

- ***Broker-dealers' and financial advisers' compensation would be required to be identical for all products.*** As noted, broker-dealers' compensation is unaffected by the proposal. The Department has stated explicitly that financial advisers are permitted to be paid more for selling products based on neutral factors, *e.g.*, products that require more time or analysis, and for platform products (see below).

- ***Broker-dealers and financial advisers could not be paid higher compensation for selling variable annuities.*** The Department's proposal would permit higher fees to be charged for selling variable annuities. The proposal explicitly states that higher fees paid for selling variable annuities would be justified by the additional time and analysis required when selling more complex products. Even if product-neutral compensation *were* required, there are broker-dealers that have demonstrated this approach is workable.[26]

- ***Broker-dealers and financial advisers could not be paid higher fees for "platform" funds that pay up for shelf space.*** The Department's proposal expressly permits broker-dealers and financial advisers to be paid higher compensation for selling platform funds. Even if higher compensation for selling platform funds *were* prohibited, there are broker-dealers that have demonstrated that not favoring platform funds is workable.[27]

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[26] *See* Report on Conflicts of Interest, *supra*, at 29 ("An effective practice FINRA observed was firms using 'product neutral' compensation grids to reduce incentives for registered representatives to prefer one type of product over another.").

[27] *See id.* at 30 ("An effective practice is that for comparable products, firms not provide higher compensation, or provide other rewards, for the sale of proprietary products or products from providers with which the firm has entered into revenue-sharing agreements. The firms with which FINRA met each stated that their registered representatives are not compensated more highly for the sale of comparable proprietary or preferred provider products.").

- ***Broker-dealers and financial advisers could not be paid higher fees for selling proprietary funds.*** The Department's proposal specifically authorizes the sale of proprietary fund under broker-dealers' existing business models, even if the funds offered are limited to proprietary funds. The proposal would not prohibit offering only proprietary funds, but some broker-dealers have demonstrated that this would be a workable approach.[28]

- ***The requirement for financial advisers to provide advice "without regard" to their own financial interests would be impossible to apply in practice because it would prevent an adviser from negotiating its own fees and/or would otherwise be unworkable.*** The Department's proposal has no effect on a fiduciary ability to charge a fee, or to charge a higher fee than its competitors, just as ERISA fiduciaries have been permitted to negotiate higher fees for decades. It is self-evident that the "without regard" requirement would only prevent a financial adviser from being paid more for making one recommendation than another, and then only if the differential does not reflect neutral criteria *and* is significant enough to prevent a recommendation from being made without regard to the differential. This means, for example, that a financial adviser could not be paid more for recommending one domestic large cap fund over another if the fund recommended generates higher compensation for the adviser. The "without regard" standard is identical to the "without regard" standard in Section 913 in Dodd-Frank Act, under which the industry now urges the Commission to enact rules while arguing that the same "without regard" standard as promulgated by the Department could not work.

- ***The prohibition against providing incentives to financial advisers that "tend to encourage" advice that is not in the client's best interest would not be workable and/or is not sufficiently clear.*** As with the "without regard" standard, the "tend to encourage" standard clearly applies only to financial incentives that have no purpose other than to encourage sales of products that generate higher revenues for the financial adviser and broker-dealer. Compliance is simple. Broker-dealers need only level compensation paid to financial advisers where there are no neutral factors that explain the compensation differential on some basis other than incentivizing sale of a higher compensation product. When the only basis for differential compensation is to incentivize the sale of the higher compensation product, a firm may run afoul of the proposed rules, as it should.

- ***Broker-dealers and financial advisers could not comply with the "reasonable compensation" requirement.*** The prohibited transaction exemption on which broker-dealers currently rely in conducting transactions subject to ERISA, PTE 86-128, already imposes a reasonableness condition.[29] The industry has

[28] *See id.*

[29] *See* Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, Prohibited Transaction Exemption 86-128 (exemption for reasonable compensation received by fiduciary for effecting or executing agency cross transaction).

considered this reasonableness requirement to be "workable" for years.[30] Moreover, the requirement that compensation be "reasonable" means only that it be within range of fees typically charged for similar products and services. This is exactly how the Commission has applied the "reasonable" commissions requirement under the Investment Company Act for decades,[31] and the financial services industry has found this standard to be "workable." Even the Securities Industry and Financial Markets Association ("SIFMA") has proposed a "reasonable fee" requirement.[32]

- ***Broker-dealers and financial advisers would be forced to move small investors into accounts that charge asset-based fees because commissions could not be charged.*** As explained above, the Department's proposal would not prohibit commission-based compensation. Investors therefore would not be forced to move to other compensation models. They would only be forced to receive less conflicted advice that was not in their best interest.

- ***The U.K. adopted similar reforms and those reforms have had an adverse effect on investors.*** Both of these claims are false. The U.K. reforms are not similar to the Department's proposed reforms. For example, the U.K. banned product-based commissions.[33] As is clear in the Department's proposal and as explained above, the Department has not proposed to ban commissions. Broker-dealers will continue to be permitted to charge commissions. There is also strong evidence that the U.K. reforms have had a positive net effect on investors.[34]

In summary, the industry's principal complaints regarding the Department's rulemaking are unfounded. In many instances, broker-dealers have adopted fee leveling and other

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[30] Ameriprise Comment Letter at 6 (June 20, 2015) (describing PTE 86-128 as a "workable" exemption) *available at* http://www.dol.gov/ebsa/pdf/1210-AB32-2-00560.pdf.

[31] The Investment Company Act prohibits fund affiliates from acting as brokers for a mutual fund if the remuneration paid "exceeds (1) the usual and customary broker's commission if the sale is effected on a securities exchange." ICA § 17(c)(2)(A). In Rule 17e-1, the Commission has interpreted "usual and customary" to mean "reasonable and fair compared to the commission, fee or other remuneration received by other brokers in connection with comparable transactions involving similar securities being purchased or sold on a securities exchange during a comparable period of time." ICA Rule 17e-1(a).

[32] SIFMA's proposal ("SIFMA Proposal") can be downloaded at: http://www.sifma.org/issues/item.aspx?id=8589954937 (last visited Sep. 5, 2015).

[33] *See Distribution of Retail Investments: Delivering the RDR - Feedback to CP09/18 and Final Rules*, U.K. Financial Services Authority at 4 (March 2010) ("Once the rules come into effect, ***adviser firms will no longer be able to receive commissions set by product providers*** in return for recommending their products, but will have to operate their own charging tariffs in accordance with our new rules.") (emphasis added). In the United States, fund commissions are, by law, fixed by fund companies.

[34] *See* Sean Forbes, *U.K., Others Provide View of Fiduciary Rule Impact*, Pension & Benefits Daily (Aug. 31, 2015) (citing studies).

conflict-neutralizing practices that go further than would be required by the Department, yet industry lobbyists claim that these practices would be impossible to implement. These practices include: (1) eliminating financial advisers' differential compensation for platform and proprietary funds, (2) capping commission compensation for financial advisers, (3) adopting product-neutral commissions and payout grids, (4) abjuring production-based payout grids altogether, and (5) limiting payout increases to prospective sales rather than also applying them retroactively.

IV. Alternative Proposals

A number of alternatives to the Department's proposals have floated by industry members and special interest groups. I discuss some of them below. One feature they generally lack is a fiduciary duty for financial advisers who provide retail investment advice. A fiduciary duty applies to an adviser's compensation. The Fidelity proposal specifically exempts an adviser's compensation from being subject to a fiduciary duty. A fiduciary duty incorporates a duty of loyalty. Neither SIFMA's nor the Financial Services Roundtable's proposal imposes a duty of loyalty. The following proposals are not workable alternatives to the Department's proposals for addressing conflicted compensation arrangements.

A. Fidelity Proposed Alternative

Fidelity's principal objection to the Department's proposal is as follows:

> the rule proposal makes an advisor a fiduciary with respect to establishment of its own services and compensation. This is both unprecedented in fiduciary law and not commercially viable, potentially requiring an advisor to recommend its competitors over itself even if its own services are wholly appropriate for the investor.[35]

While Fidelity is correct as to the effect of the proposal, it is not correct that subjecting an

[35] Fidelity Comment Letter (July 21, 2015), *available at* http://www.dol.gov/ebsa/pdf/1210-ZA25-00157.pdf.

adviser's or other person's fees or services is unprecedented or not commercially viable. Trustees, under trust law, have been subject to a fiduciary duty with respect to their fees and services for centuries. Investment advisers, under the Investment Advisers Act, have been subject to a fiduciary duty with respect to their fees and services for decades. And fiduciaries under ERISA, including Fidelity, have been subject to a fiduciary duty with respect to their fees and services for decades, although the Department has granted many exemptions to make firms' obligations workable under ERISA. In each case, trustees, investment advisers and ERISA fiduciaries have found compliance with their duties to be commercially viable, and they have never had to recommend a competitor over themselves.

In fact, for decades financial advisers who act in a discretionary capacity or have a relationship of trust and confidence with their clients, including Fidelity financial advisers, have been subject to a fiduciary duty.[36] The most common claim made in arbitration against financial advisers is breach of a fiduciary duty.[37] Thus, Fidelity's recommendation that advisers not be subject to a fiduciary duty with respect to their fees flatly contradicts current law and reflects a standard that is *lower* than the current legal standard as applied to advisers under securities law.

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[36] *See, e.g., United States v. Wolfson*, 642 F.3d 293 (2d Cir. 2011) ("Although we have long held that there "is no general fiduciary duty inherent in an ordinary broker/customer relationship," we have also recognized that "a relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker." ... [A] discretionary account is not the sole means by which a fiduciary duty may be created in the context of a broker-customer relationship; we have "recognized that particular factual circumstances may serve to create a fiduciary duty between a broker and his customer even in the absence of a discretionary account." ... Put otherwise, it is well settled in this Circuit that the presence of a discretionary account automatically implies a general fiduciary duty between a broker and customer, but the absence of a discretionary account does not mean that no fiduciary duty exists.").

[37] Fiduciary duty breach claims have been the most common every year at least from 2008 through 2014. *See* Dispute Resolution Statistics, Fin. Indus. Regulatory Auth., *available at* http:// www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/ Statistics/ (last visited Sep. 5, 2015); Mercer Bullard, *The Fiduciary Standard: It's Not What It Is, But How It's Made, Measured and Decided*, 87 St. John's L. Rev. 337, 369 – 78 (2013) (discussing arbitration). Arbitration panels are not required to explain the basis of their decisions, so it is unknown how often they find a breach of a fiduciary duty. However, on occasion a panel will reveal its reveal its findings. *See, e.g., Billings v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, FINRA Arbitration No. 11-01948 (Oct. 12, 2012) (finding respondent violated fiduciary duty to claimants and awarding monetary relief) *available at* http://finraawardsonline.finra.org/viewDocument.aspx? DocNb=59344.

What Fidelity may mean is that it disagrees with the effects of being a fiduciary under ERISA, which are certainly different from the effects of being a fiduciary in other contexts. But its blanket statement that it is "unprecedented" to subject an adviser to a fiduciary duty with respect to their fees and services is simply incorrect. It is not unprecedented. It is quite common.

Fidelity's proposal is to separate the adviser's fees and services from its recommendations. The financial adviser's recommendations would be subject to a best interest standard, but conflicted compensation would not. Thus, Fidelity's proposal does not create a fiduciary duty with respect to conflicted compensation that tends to encourage the sale of higher cost products. The conflicted compensation arrangements that Fidelity's proposal would exempt from being subject to a fiduciary duty are precisely the conflicts that are the *raison d'etre* of the Department's rulemaking.

Fidelity equates the situation where a "person who is already providing investment advice to a plan 'persuades' a plan fiduciary to extend his contract at a higher fee" to financial advisers' compensation, arguing that "[t]here is no reason why this concept should not apply where the advisor's compensation varies based on the transactions and services recommended." Actually, there is a very good reason. Conflicted compensation is not about paying more or less for a given set of services or negotiating a higher fee. It is about compensation for a given set services – investment recommendations – *that varies based on the recommendation made by the adviser*. A doctor, lawyer or priest can negotiate a higher fee or salary consistent with their fiduciary duties. However, a doctor should not be paid more for an office visit for recommending one drug over another. A lawyer should not be paid more for interpreting the law one way rather than another. A priest should not be paid more for giving one kind of spiritual advice over another. Fidelity's comparison to negotiating a higher fee misses the point.

Fidelity's second primary objection to the proposal is that it is "unworkable." As discussed above, the proposal is eminently workable. Although Fidelity has provided a number of constructive comments and recommendations regarding how to improve the

proposal in its comment letter, its suggested alternative approach is inadequate because it simply does not regulate conflicted compensation practices.

B. SIFMA Proposed Alternative

The Securities Industry and Market Association ("SIFMA") has proposed as an alternative to the Department's rulemaking that comprises only a set of amendments to FINRA rules.[38] In other words, SIFMA is opposed to broker-dealers being ERISA fiduciaries. Its proposal does not address non-securities, over which FINRA has no jurisdiction. Its proposal rejects the foundational premise of ERISA that retirement assets are deserving of more protection than other assets. Its proposal does not provide a reasonable alternative.

SIFMA claims that the Department's proposal creates an "additional standard of care." That is incorrect. The Department has stated that a recommendation that may trigger fiduciary status is a recommendation as determined under FINRA rules. FINRA rules already impose a suitability standard. As the table on the right illustrates, the Department has essentially adopted FINRA's suitability duty of care standard. The table makes it clear that the Department has not proposed an "additional" standard of care."

DOL Duty of Care BIC PTE II(c)(1)	FINRA Suitability Duty of Care Rule 2111(a)
When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will provide investment advice that is in the Best Interest of the Retirement Investor (*i.e.*, advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor	A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

SIFMA's proposal would have no effect on conflicted compensation arrangements. It would require that these arrangements be "managed" and that steps be taken to ensure

[38] *See* SIFMA Proposal, *supra*.

that recommendations are not "materially" compromised by "material" conflicts of interest. However, FINRA has made it clear that it does not object to blatant conflicts of interest that violate current FINRA rules. SIFMA prefers that federal securities regulators tacit approval of conflicted compensation arrangements set the bar. As the above description of conflicted compensation arrangements demonstrates, the status quo is unacceptable.

SIFMA contends that there should be a uniform fiduciary duty for all retail brokerage accounts, that it should "serve as a benchmark for, be consistent with, and integrate seamlessly into, the SEC uniform fiduciary standard that ultimately emerges under Dodd-Frank § 913," and that it should "follow the traditional securities regulatory approach." Congress could satisfy SIFMA's wishes in this respect, but the Department cannot. Congress specifically decided in enacting ERISA to impose a higher duty with respect to retirement assets than to other accounts subject only to securities regulation, and to impose that standard to non-securities (a distinction that SIFMA ignores). Congress specifically included IRAs as covered retirement assets. SIFMA's wishes do not run contrary to the Department's proposal. They run contrary to the statute that the Department is required to apply.[39] SIFMA, like FINRA, disagrees with the fundamental premise on which ERISA is based, that Americans' retirement security deserved heightened protection.[40]

SIFMA's proposed amendments to FINRA rules do not impose a fiduciary duty on financial advisers and, in many respects, weaken existing standards applied by FINRA. Nor does SIFMA's alternative provide for private enforceability, much less for a binding contractual commitment. For example, SIFMA proposes that investors be permitted to

[39] SIFMA notes that "FINRA CEO Ketchum, in his remarks at the FINRA Annual Conference on May 27, 2015, reinforced many of these same points. 'It is not optimal,' he stated, 'to apply a different legal standard to IRAs and 401(k)s than to the rest of an investor's assets.'" The same statements were made in FINRA's comment letter to the Department. Subcommittee members should pay close attention to these statements. In both cases, FINRA not only has rejected a regulatory structure that has existed for decades, but also has cast doubt on its understanding of and willingness to enforce existing law. FINRA's comments reflect the interests of private industry (its members), not the investors it is statutorily required to protect.

[40] *See id.*

"waive" or "consent to material conflicts" of interest, which defeats the investor protection purpose of a fiduciary duty. The centuries-old purpose of a fiduciary duty is to protect investors who are vulnerable or at informational disadvantage, which impairs their appreciation of waiving their rights. SIFMA would require disclosure of material conflicts of interest without any requirement to disclose conflicted compensation, much less the amount of or differences in such compensation, which comprises less disclosure than is currently provided by most broker-dealers. SIFMA would deem all existing customers to have consented to "material conflicts of interest" based solely on such inadequate disclosure, thereby assuming consent where the investor has not actually consented.

C. FSR Proposed Alternative

FSR has proposed an alternative to the Department's BIC exemption.[41] However, although FSR claims to support a "best interest" standard and that its proposed PTE "codifies a best interest standard," its alternative PTE does not apply a best interest standard. FSR would require that a financial adviser's recommendation to a client:

> (i) reflects the care, skill, prudence, and diligence under the circumstances then-prevailing that a prudent person would exercise; and (ii) provides the Retirement Investor with an opportunity for an appropriate return, risk exposure, or benefit taking into account the Retirement Investor's unique needs as disclosed by the Retirement Investor to the Adviser and/or Financial Institution.

A fiduciary duty comprises a duty of care *and* a duty of loyalty. The FSR's standard reflects a duty of care; it does not include a duty of loyalty. FSR's PTE nowhere references a financial adviser's duty of loyalty. The primary purpose of the Department's proposal is not to establish a higher standard of care. It is to create a higher duty of loyalty, and to apply a kind of loyalty standard to compensation that improperly incentivizes financial advisers to sell higher compensation products. However, nothing in the FSR's PTE would prohibit financial advisers from making recommendations based

[41] FSR's Simple Investment Management Principles and Expectations Prohibited Transaction Exemption begins on page 101 of FSR's written submission to the Department in connection with its testimony on August 10, which can be accessed at: http://www.dol.gov/ebsa/pdf/1210-AB32-2-WrittenTestimony6.pdf.

solely on their own financial interests so long as such recommendations could be defended as being within the range of what is prudent.

FSR's proposal requires that firms adopt procedures to mitigate material conflicts of interest, but it defines "material conflict of interest" in a way that would expressly exclude conflicted compensation even it was *likely* to affect a financial adviser's recommendation. FSR defines a "material conflict of interest" as a financial interest that creates a "substantial likelihood that a reasonable Retirement Investor would attach importance" to that interest in deciding whether to take or refrain from taking a particular action. This standard misses the point. The issue is not what is important to an investor. The question is not whether the investor would consider something important. The investor is not making an investment decision. The investor has decided to place his or her trust and confidence in the financial adviser. The issue, as even the SIFMA proposal expressly recognizes,[42] is the likelihood that conflicts of interest will adversely affect *financial adviser's recommendations*.

Nor is FSR's "substantial likelihood" standard appropriate. If a conflicted compensation is "likely" – but not "substantially likely" – to affect a financial adviser's recommendation, there is no question that the compensation should not be permitted. FSR's position is that conflicted compensation that is "likely" to affect a financial adviser's should be permitted. This position is indefensible.

FSR defines "recommendation" as comprising only an "explicit suggestion" that the investor engage in or refrain from engaging in a "specific transaction or transactions." Financial advisers could easily frame their recommendations so as not to be "explicit" or "specific" so as *never* to trigger any of the PTE's requirements. This definition conflicts with the meaning of "recommendation" under FINRA rules.

Section V of FSR's proposal would provide a blanket exemption for all compensation received in connection with the purchase of an investment prior to the PTE's effective

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[42] *See* SIFMA Proposal, *supra* (requiring that recommendations "[a]void, or otherwise appropriately manage, disclose, and obtain consents to, material conflicts of interest, and otherwise ensure that the ***recommendation is not materially compromised by such material conflicts.***) (emphasis added).

date. In other words, financial advisers could continue to advise a client, for example, to retain an investment that paid higher compensation even if it would be in the client's best interest to switch to a lower cost investment. This standard is lower than FINRA's current suitability standard, which applies to recommendations to hold investments, and, like many aspects of FSR's proposal, ignores existing broker-dealer regulation.

Finally, FSR's alternative does not create a contractually binding commitment for the paltry standards that it imposes. In arbitration proceedings, FSR's proposal would give defendants a basis for arguing for a standard under the FSR PTE that is lower than the current standard under FINRA rules. In summary, the FSR standard would be worse than no standard at all.

Statement of Caleb Callahan
Senior Vice President and Chief Marketing Officer, ValMark Securities, Inc.
On behalf of the Association for Advanced Life Underwriting (AALU)

Hearing on Preserving Retirement Security and Investment Choices for All Americans

Before the Subcommittees on Oversight & Investigations and Capital Markets and Government Sponsored Enterprises of the House Financial Services Committee

September 10, 2015

Chairmen Duffy and Garrett, Ranking Members Green and Maloney, and Members of the Committee, I am Caleb Callahan, Senior Vice President and Chief Marketing Officer at ValMark Securities, Inc. I am testifying today on behalf of the Association for Advanced Life Underwriting (AALU), of which I am Chairman of the Retirement Planning Committee and ValMark is a strong supporter and partner. AALU appreciates the opportunity to testify before the Subcommittees on Oversight & Investigations and Capital Markets & Government Sponsored Enterprises at this joint hearing on the proposed rule to redefine who is a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA) and Section 4975 of the Internal Revenue Code of 1986, including individual retirement accounts (IRAs), and on Representative Ann Wagner's (R-MO) Retail Investor Protection Act (HR 1090).

AALU is the leading organization of life insurance professionals who are a trusted voice on policy issues impacting Americans' financial security and retirement savings. Our 2,200 members nationwide are primarily engaged in sales of life insurance used as part of retirement, estate, charitable, and deferred compensation and employment benefit services.

ValMark was founded in 1963, and has roughly $14 billion in assets under care. We provide both fee-based (registered investment advisor) and commission-based (broker-dealer) solutions to retirement savers—with roughly 55% of our business in 2015 on the investment advisor side and 45% on the broker side. Our model of providing both types of solutions enables us to have a level of independence and objectivity that allows client goals to drive the best solution. In our experience, both models for receiving advice and products are chosen regularly.

My goal here today is to offer feedback on the DOL's proposed fiduciary rule based on the real world experience of our firm working directly with advisors and retirement savers. This rule is well-intentioned, with the goal of helping Americans save for retirement, but unfortunately it will have the exact opposite result—harming the people we serve every day. It is our clients and advisors on whose behalf I speak today, and I will explain why preserving our clients' right to make choices in their best interest—as THEY determine it—is essential.

I also want to express AALU's continued support for the Retail Investor Protection Act (HR 1090) introduced by Representative Ann Wagner (R-MO). Her legislation would, in essence, require the SEC to identify a real need and determine that there will be real benefits outweighing the costs before upending the current standards that apply to broker-dealers. AALU truly appreciates Rep. Wagner's leadership on this issue—we have been long-time supporters of her legislation, which is a sensible proposal that will lead to better rulemaking on standard of care issues.

The Department Hasn't Worked Within the Current Regulatory Framework—Including Its Own Previous Efforts

I will start out by asking why the DOL took this step without first trying to work within the current regulatory framework.

As committee members are well aware, the SEC has extensive experience regulating under a fiduciary duty, yet it is unclear if their deep knowledge has been fully brought into the process—we certainly don't want a rule that conflicts with SEC regulations and initiatives. FINRA also has significant expertise and authority in this space, yet it submitted a comment letter to the DOL outlining a number of concerns about the proposed rule. In the letter, FINRA explained that the proposed rule did not sufficiently build on existing regulation, and in several respects conflicts with current FINRA rules and securities market trading practices. FINRA further notes that this "fractured" approach will confuse retirement savers and advisors, and cause many broker-dealers to stop serving average savers.

Particularly concerning is the implicit assumption that there are serious problems with the sale of annuities and lifetime income products. AALU feels that these products are already the subject of robust regulation, and the DOL has not presented any data showing serious deficiencies with the current framework.[1]

In fact, the Department didn't even build on its recent good work to improve investor understanding in the ERISA marketplace, or show why such initiatives could not be successfully refined to address any remaining issues in the marketplace—despite the considerable time and effort that both the DOL put into crafting these rules and that the financial services industry expended to comply with the regulation.

As many of you know, in February 2012 the DOL issued final 408(b)(2) disclosure rules for retirement plans for the purpose of bringing clarity to consumers. The new disclosure rules requiring advisors to disclose: 1) the services they provide, 2) whether these services are provided in a fiduciary or brokerage capacity, and 3) the fees charged for such services.

In examining the business metrics of ValMark's own advisors throughout the country from 2013 (the first full business year following final disclosure regulations) and 2014, there is a clear trend that under these recently finalized disclosure rules advisors are increasingly becoming fiduciaries and charging fees as opposed to selling plans as brokers for a commission. For example, when comparing year-end 2013 results to year-end 2014 results, commission-based plans grew at a rate of 26% while fee-based plans grew by 114%. When we filter this data down to the firms whose primary business is qualified plans, the trend is even more prominent. The qualified plan specialist advisors saw a decline of commission-based plans by 85% between 2013 and 2014 but a 21% increase in the sale of fee-based plans.

These metrics evidence a noticeable shift in the business model. Conversations with our advisors reveal that this shift is directly tied to the new 408(b)(2) disclosure regulations. The data shows that in an environment of enhanced disclosure there is a move for advisors to increase the number of services they provide and do so in a fiduciary capacity. However, notwithstanding this trend, some consumers still choose to engage advisors in a brokerage capacity based on account size, needs and goals.

In short, it does not seem prudent for the Department to move forward with new sweeping regulation in the retirement savings marketplace given the experience and expertise of the SEC and FINRA—particularly since the DOL has not even conducted a full examination of comparable rules recently issued

by the Department in this same space, and which preliminary trends at our business indicate are achieving their intended result.

The Retail Investor Protection Act Provides a More Appropriate Framework

Given the Department of Labor's failure to work within the current regulatory framework, Representative Wagner's Retail Investor Protection Act (HR 1090) is an important bill that will lead to better rulemaking on standard of care issues.

This legislation will prohibit the DOL from issuing a fiduciary rule under ERISA before the SEC acts in accordance with Section 913 of the Dodd-Frank Act. Further, the SEC would be required to provide a report to both the House Financial Services Committee and the Senate Banking Committee showing that current standards are causing harm before issuing a rule, and explain whether the rule will limit access to professional financial advice. The SEC would also be required to investigate alternative solutions to a uniform standard of care, such as enhanced disclosures, to address any identified issue.

Rep. Wagner's Retail Investor Protection Act is a thoughtful piece of legislation that will protect average retirement savers from losing choice and access to professional financial advice, and AALU supports its passage.

DOL Proposal Contradicts Other Government Goals and Initiatives

Not only does this proposed rule fail to build on the current regulatory framework, it also contradicts other governmental goals and initiatives.

Policymakers on both sides of the aisle understand that helping Americans adequately save for retirement is a top priority. In 2011, the Government Accountability Office (GAO) released a study at the request of Congress entitled "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," with the DOL and Treasury providing key contributions to this report. The study noted that with the steep decline in defined benefit pension plans and the rise of defined contribution plans, individuals are increasingly faced with difficult decisions about managing their financial assets to secure lifetime income.

While of course noting that increasing savings and investing wisely are crucial to achieving sufficient retirement income, the report stresses two fundamental points: 1) the importance of annuities for retirement savers; and 2) the benefits of delaying the receipt of social security and working longer.

The GAO report highlights the importance of annuities for American's retirement security. In fact, the financial experts interviewed for this GAO study typically recommended that retirees convert a portion of their savings into an annuity, and the report specifically encourages their increased utilization in qualified plans. In particular, the study highlights that middle quintile households have the most need for annuities and lifetime income solutions—while wealthier individuals can weather a financial storm, it's the average retirement saver that is most in need of access to annuities.

In addition, the GAO study makes clear that the decision to delay the receipt of social security is a crucial factor in the retirement security equation. Working longer and taking social security at a later age can result in significantly more income in retirement.

Yet the study also clearly indicates that access to professional financial advice is critical. It's not just instructing individuals about the increased savings that delayed receipt of social security can bring—making the optimal choice requires education and calculations that are tailored to each retiree's unique circumstances, including anticipated expenses, income level, health status, and risk tolerance. Professional financial advisors can guide individuals through their various options and construct a personalized plan that will provide sufficient income in retirement. Unfortunately, this rule would make providing this type of advice significantly harder, if not impossible.

Building on the recommendations of the GAO study, the Treasury Department—recognizing the need to offer lifetime income streams in qualified plans—finalized regulations in 2014 which promoted the use of Qualified Longevity Annuity Contracts (QLACs). Insurance companies and financial institutions have just begun building solutions to comply with these recently issued regulations, and for the first time in 2015 there are multiple QLAC solutions that retirement savers can access in the marketplace. The DOL proposed rule would make it difficult, if not impossible, for our business to offer these critical retirement savings products to our clients, contradicting this Treasury Department initiative and sending a conflicting message to Americans.

The DOL's proposed rule also conflicts with initiatives at the SEC. For example, the Commission has listed combatting reverse churning—putting clients that aren't actively trading into fee-based accounts when a commission-based account would be a better, more affordable option–as an important priority. Many investors execute buy and hold strategies, with little to no trading over a number of years. For these savers, a fee-based account would mean paying an annual fee despite not needing or receiving any advice or services. A commission-based account would be more appropriate, only charging them when they need service from their advisor.

In other words, the SEC has made it very clear that fee-based accounts are NOT appropriate or the best deal for some retirement savers. Yet the DOL proposal would force many businesses like mine to basically put all of my clients into fee based accounts–directly contradicting this SEC initiative.

The Proposal Contains Unworkable Exemptions for Commission-Based Business Models—Resulting in Reduced Choice and Access for Average Retirement Savers

I would now like to focus on why this rule will ultimately result in reduced choice and access for average retirement savers by providing real world examples from my business. The DOL claims that the proposal is business-model neutral, but based on my experience this rule is not compatible with current commission-based business models—as FINRA CEO Rick Ketchum has himself noted.

The AALU continues to support clear, concise disclosures about the roles and obligations, product offerings, and material conflicts for all financial advisors, including broker-dealers and life insurance professionals. Yet while it is important to alleviate any investor confusion in the marketplace, regulators must ensure that consumers have meaningful choice when making decisions about their investments and retirement savings.

Unfortunately, this proposed rule makes it difficult, if not impossible, for our business to continue providing valuable life insurance and lifetime income products that offer the only solutions allowing retirement savers to transfer longevity risk and market sequence of return risk to third parties.

This loss of access to lifetime income products is particularly troubling because Americans are increasingly unprepared for retirement. In fact, many experts feel that we are facing a retirement crisis. Americans that reach retirement age are living longer than ever, yet many Americans have very little savings at all—in fact, almost 50% of households age 55 and older have no retirement savings in vehicles such as a 401(k) plan or an IRA.[ii] Further, 57% of workers reported that the total value of their entire household's savings and investments—not just for retirement—was less than $25,000, and 28% had less than $1,000.[iii] Survey after survey shows that retirement security is one of the top concerns for Americans. In short, this is exactly the wrong time to be restricting access to products that provide lifetime income.

The aforementioned 2011 GAO report discusses the significant under-utilization of annuities by investors—particularly median income savers—and academics wonder why many more retirees don't annuitize defined contribution benefits given the protection they provide.

Part of the reason is that research shows individuals often underestimate the value of an annuity. Life insurance producers have to educate savers about the benefits of annuities, and walk them through their various options. They also have to obtain detailed information about the individual's specific circumstances to appropriately tailor the product to best fit their needs. Unfortunately, the restrictions on advisors under this rule—from the definition of fiduciary to the conditions set forth by the BICE—will prevent our advisors from continuing to provide valuable advice to retirement savers.

In addition, annuities are buy-and-hold products by their very nature. As I discussed with reverse churning earlier, it can be much more expensive for investors that hold positions for long periods of time to be in fee-based accounts. With annuities being held in accounts for long periods of time without trading or advice around these products, commission-based accounts often offer the best choice for investors.

Quite simply, commission-based advice represents the most inexpensive option for small retail investors to receive education and access to annuities and lifetime income products. This rule will make it difficult to provide the only solution retirement savers have to transfer a portion of longevity risk and market sequence of return risk to a third party.

And it's not just access to annuities; ValMark's clients will lose access to professional financial advice and other retirement savings products.

The United Kingdom banned commissions in 2013, and it serves as example of what the DOL proposal would portend if adopted. In a study on the impacts of the Department's proposal on U.S. life insurers, Oliver Wyman found that, "While commission structures will still exist in the US, we believe that the trajectory of change is close enough to that in the UK and Australia that similar impacts will occur here. These changes will significantly affect competitive dynamics in a manner that could have profound impacts on market participants."[iv]

In the wake of the U.K. commission ban, the largest banks have significantly raised the minimum account balances required before they will offer financial advice to investors. And in the year before the commission ban went into effect, the number of advisors serving retail accounts plunged by 23%.[v] In fact, within the last month the U.K. initiated a review of the advice gap for small accounts that has occurred since 2013—a clear sign of the reduced access caused by the commission-ban.

The marketplace reality is that it is often not cost-effective to provide fee-based services to smaller retail investors. For example, fee-based advisors typically charge investors a flat fee of 1% of the assets in their account, so for an IRA with a $5,000 balance the advisor would get $50 in fees, not enough to cover the costs of providing round-the-clock fiduciary service and the attendant liability.

Let me explain the disruption this rule would cause by providing a recent personal example involving my parents. They are 64 years old, and have saved about $25,000 for their retirement. The other day my Mom called me to ask a variety of retirement questions:

> *Should we file for social security now? Should we file and suspend? Should we use some of our savings to pay down our mortgage?*

These are the types of important and difficult questions that my Mom asked, and she didn't have the right answers on her own. I was of course willing to spend a couple of hours going over these questions with my parents because I love them, and I expect to spend many more hours in these types of conversations with them. However, a fee-based advisor will not be willing to spend the time necessary to walk them through these options, as they would typically only make $250 on this type of account. Unfortunately, this proposed rule will make it difficult for many near-retirees that don't happen to have sons working in the financial industry.

In addition to a loss of access to professional financial advice, retirement savers are being denied the ability to make basic choices about what's best for their future. When protecting their families and saving for retirement, individuals must be able to choose what is right for them.

As discussed, long-term investors may prefer a single point-in-time payment over an ongoing, annual obligation that increases as does the value of their investment account. For many investors, the annual fee can add up to far more money paid than a point-in-time commission. To take away the right of consumers to choose the type of services they need is not in the best interest of average retirement savers.

Other markets do not restrict choice. Consumers are afforded the independence and freedom to make decisions about purchases based on their own determinants of value—including items that have a significant impact on retirement savings such as a home. Great platforms like standardized disclosures, data conformity, good faith estimates, consumer reports, and social media feedback are available to aid consumers in their decisions. Cheapest is not always best, and every individual will make choices based on their own determination of value relative to their goals and situation.

In addition, insurance products are distinctly different from other financial products, such as a mutual fund, and offer unique benefits. Forgoing insurance is always initially cheaper than obtaining insurance coverage—whether a house, car, etc. But whether it truly costs more is something that is unknown because it depends on future events. If we could predict the future we wouldn't need solutions like this, but of course that is the very concept of insurance—transferring risk to third parties that are better able to withstand it. Yes, consumers pay for the protection and financial security that insurance products provide—it's not free—but that is a choice individuals should be able to make.

Average Investors Have Better Investment Performance When Using Professional Advisors

The Department has chosen to focus on one area related to saving for retirement: costs. And it is certainly worthwhile to ensure that investors are best served by their professional advisors. But besides ignoring other risks faced by retirement saves such as longevity risk, the Department creates a new one: the risk that many more investors will be making investment decisions on their own.

The prospect of average retirement savers facing critical retirement savings decisions without access to professional financial advice is disturbing, because documented studies have repeatedly concluded that investors who do not have an investment professional consistently achieve lower returns than investors who use a professional advisor.

For example, the decision to stay invested in the market during times of stress is the biggest factor affecting retirement savings over the long-term. According to a recent analysis from Robert Litan and Hal Singer, restricting access to face-to-face professional advice during a future market swoon could cost investors $80 billion.[vi] In another recently released study, Oliver Wyman found that investors using professional advisors have a minimum of 25% more assets than investors without professional advisors, and concluded that "advised individuals are more sophisticated and diligent long term investors who achieve better investing outcomes."[vii] And a 2014 LIMRA study outlined the important benefits from working with professional financial advisors, and noted that many consumers—particularly younger investors—desire additional advice and guidance about decisions related to their financial and retirement security.[viii]

Summary

AALU believes that the DOL has prematurely jumped for a "solution" in the retirement savings marketplace without fully stating or quantifying why this proposed rule is necessary or explaining why the existing regulatory framework cannot be built upon to address any problems. Further, the rule directly contradicts other governmental goals and initiatives, creating conflicts that will harm retirement savers.

While we appreciate the intent of the DOL to ensure that clients' best interests are being served, this rule will have the opposite effect—reducing choice and access to professional financial advice for average retirement savers. This is why we support Rep. Ann Wagner's Retail Investment Protection Act (HR 1090), which will lead to better rulemaking on standard of care issues for brokers and financial advisors.

Thank you for giving me the opportunity to testify today. I am happy to serve as a resource for committee members as you work to determine the impacts of the DOL's proposed fiduciary rule—and press for a more effective course of action to serve the needs of average retirement savers.

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[i] For a more detailed discussion of the extensive regulation of life insurance professionals and the services and products they provide, *see* Letter from David J. Stertzer, Chief Executive Officer, AALU, to Elizabeth M. Murphy, Secretary, SEC, File No. 4-606, (Aug. 30, 2010), available at: http://www.sec.gov/comments/4-606/4606-2631.pdf; *see also* Letter from David J. Stertzer, Chief Executive Officer, AALU, to Elizabeth M. Murphy, Secretary, SEC, File No. 4-606 (July 1, 2013), available at: http://www.sec.gov/comments/4-606/4606-3092.pdf; *see also* Letter from

David J. Stertzer, Chief Executive Officer, AALU, and Jack Chiasson, Chief Executive Office, NAILBA, to U.S. Department of Labor, available at: http://www.dol.gov/ebsa/pdf/1210-AB32-2-00696.pdf.

[ii] United States, Government Accountability Office, "Most Households Approaching Retirement Have Low Savings," May 2015. Accessed July 21, 2015. Available at: http://www.gao.gov/assets/680/670153.pdf.

[iii] United States, Senate Finance Committee, "The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis," AARP, December 18, 2013. Accessed July 21, 2015. Available at: http://www.finance.senate.gov/imo/media/doc/AARP%20Final%20Social%20Security%20SubCommittee%20Testimony.pdf.

[iv] Mick Moloney, Ramy Tadros, David Clarkson, and Anthony Bice, "Distribution Disruption: Impacts of the Department of Labor Fiduciary Standard for U.S. Life Insurers," Oliver Wyman, 2015. Accessed July 21, 2015. Available at: http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2015/jun/Oliver_Wyman_Distribution_Disruption.pdf.

[v] Kent Mason, "SaveOurRetirment.Org: Missing the Key Issue," Davis and Harman LLP, February 3, 2015. Accessed July 21, 2015. Available at: http://saveourretirement.com/MissingTheKeyIssue.pdf.

[vi] Robert Litan and Hal Singer, "Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department Of Labor's Proposed Fiduciary Rule," Economists Incorporated, July 2015. Accessed: August 11, 2015. Available at: http://www.dol.gov/ebsa/pdf/1210-ZA25-00070.pdf.

[vii] "The role of financial advisors in the US retirement market," Oliver Wyman, July 10, 2015. Accessed July 21, 2015. Available at: http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirement-market-Oliver-Wyman.pdf.

[viii] "Matters of Fact: Consumers, Advisors, and Retirement Decisions (and Results)," LIMRS Secure Retirement Institute, May 2015. Accessed July 21, 2015. Available at: http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/Facts-about-retirement-decisions.pdf.

National Association of Insurance and Financial Advisors

Statement for the United States House of Representatives, Committee on Financial Services, Subcommittee on Oversight and Investigations and Subcommittee on Capital Markets and Government Sponsored Enterprises

"Preserving Retirement Security and Investment Choices for All Americans"

Juli McNeely
President
National Association of Insurance and Financial Advisors

September 10, 2015

National Association of Insurance and Financial Advisors

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Good morning Chairmen Duffy and Garrett, Ranking Members Green and Maloney, and Members of the Subcommittees. My name is Juli McNeely, and I am testifying today on behalf of the National Association of Insurance and Financial Advisors ("NAIFA") for whom I currently am serving as President. Thank you for giving us this opportunity to share our perspective on "Preserving Retirement Security and Investment Choices for All Americans."

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

I also am a small business owner as I own my own agency – McNeely Financial Services, Inc. based in Spencer, Wisconsin. I am licensed to do both fee and commission-based work but the vast majority of my work is done on a commission basis because that compensation mechanism generally makes the most sense for my clients. I have 52 small-business clients, most of which have fewer than 25 employees, and 484 individual clients who have an average account size of $70,982. We offer the small business clients group benefit and retirement plan products and advice; we offer individual clients a full range of investment and retirement products and advice, including retirement planning, college funding and investing for other future goals. Many of my clients start out as new savers, and I believe that many of them would not have become savers at all without my assistance and advice.

I intend to focus my testimony today on three core themes:

1. The critical need for main street Americans to access financial advice. We continue to have a savings crisis in this country and impeding the providing of advice will only exacerbate that problem.

2. We are concerned that the Department of Labor "fiduciary duty" proposals – while well-intended – will impose a wide range of new administrative requirements along with a "best interest" standard that invites litigation regarding what satisfies that standard. Through the imposition of these requirements on advisors who are paid on a commission basis, the proposal implicitly favors a fee-for-service model that does not work for most Americans of modest means. The Department has expressed its commitment to revising the proposal to address many of the identified concerns, but they do not appear to intend to issue a re-proposed rule meaning that we will not receive a clean opportunity to fix

issues that inevitably will arise when revisions of this magnitude are made. At a minimum, we hope that the Members of these Subcommittees will encourage the Department to re-propose the rule if it intends to proceed with this rule-making process.

3. If enacted, H.R. 1090, the "Retail Investor Protection Act" ("RIPA") would stay the Department of Labor fiduciary duty rulemaking process until the Securities and Exchange Commission ("SEC") has reported to Congress regarding whether the imposition of new duties and obligations is advisable and until the SEC has had the opportunity to issue any such rules if it concludes that it is advisable. Moreover, the one issue the Department of Labor cannot rectify unilaterally is the disharmony that its proposal will create between investments sold through Individual Retirement Accounts and those sold outside of the retirement context; only the SEC can issue rules that would impose a uniform standard in both contexts. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes, none of which would advance any legitimate public policy objectives. For these reasons, NAIFA supports RIPA.

After a brief background section on NAIFA, its members and our clients, I discuss these points in more detail below. In addition, we also are submitting copies of the two comment letters we filed with the Department of Labor which outline our specific concerns with individual elements of the Department's proposals in more detail and which suggest ways in which some of the proposed elements we believe are damaging or burdensome can be ameliorated or corrected.

Background

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[1] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

[1] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

Despite Secretary Perez's statement before Congress on June 17, 2015 that the Department's proposal makes things "simpler" by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed DOL rules are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS – LESS ACCESS TO MORE EXPENSIVE ADVICE

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[2] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[3] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[4] Roughly 45% of people said they plan to

[2] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[3] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[4] *Id.*

rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[5]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by making it both more expensive and harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The

[5] *Id.*

proposal's burden on independent advisors and registered representatives is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and we know is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[6] And small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[7] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[8] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[9]

B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;

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[6] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014).

[7] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3 (a copy of which is attached to the DOL Comment Letters as Exhibit 3).

[8] Oliver Wyman Study, at 6.

[9] LIMRA Survey, at 13.

(2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or

(3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[10] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[11] Thus, ultimately, fee-based models actually will raise costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

This is in part because fee-based arrangements generally impose fees on all of the assets under management whereas commission arrangements generally only generate compensation for the purchase of new assets. The attached Exhibit 1 shows an illustration of this. In the example, an investor opens a new mutual fund account and deposits $1,200 annually in the new account for 20 years. The assumed commission load for a managed account – 5.75% – would be paid on new contributions that are made to the account but the only "trailing" compensation that is generated on the overall assets in the account is a standard 0.25% 12b1 fee. Generally, no new contribution commission is paid when an investor moves money between funds in the same fund family and, for that reason, I work closely with my clients to ensure that they keep their investments within a single fund family. Over the 20 year period, the commission model would generate $2,344.54 for the advisor under this example.

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[10] Oliver Wyman Study, at 6.

[11] *Id.*, at 7.

The exhibit also shows two fee arrangements, both of which are very conservative especially for relatively small asset accounts like these. Using a fee of just 1.2%, the amount of fees generated for the advisor over the same 20 year period -- $4,521.39 – is almost double what the commissioned advisor received.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87% of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes if and when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. This result is also contrary to the Department's goals, which include encouraging lifetime income payout options like annuities.

We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why the Department has traditionally held a favorable view of most annuity products. Somewhat ironically, however, the Department's proposal imposes a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[12] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Proposal Must Accommodate Proprietary Products

Another problem posed by the complex best interest contract element of the Department's proposed rules involves the situation in which the advisor is a registered representative of a broker-dealer that restricts the products that the advisor can sell. This is the proprietary products issue. Because of complex ERISA self-dealing rules, when an advisor can offer only his or her own broker-dealer's products, it becomes difficult—perhaps impossible—for that advisor to comply with the best interest contract PTE at all. This would foreclose the ability of this kind of advisor to help his or her clients save for retirement at all unless he or she charged the client upfront non-product specific fees for advice. As explained earlier, this is simply not an option for most middle income Americans whose modest means make such a fee-for-advice model unaffordable or unappealing to the retirement saver. The Department's proposal simply must be modified to accommodate that slice of the market that involves the sale of proprietary products.

E. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

[12] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it purportedly is seeking to protect. A full discussion of NAIFA's specific issues and concerns with the proposed rules – as well as many suggested potentially corrective measures – is included in the comment letters NAIFA filed with the Department which are attached hereto as noted above.

NAIFA SUPPORTS H.R. 1090
AS A WAY TO ENSURE SAVERS HAVE ACCESS TO AFFORDABLE RETIREMENT ADVICE

In response to concerns that investors were confused about what duties were owed to them when advisory services were provided by an "Investment Advisor" as opposed to when the services were provided by a "Broker-Dealer Representative," Congress directed the SEC in Section 913 of the Dodd-Frank Wall Street Reform Act to harmonize the duties between investment advisors and representatives. This was done in part because of the perceived success of similar reforms in the United Kingdom. Just last month, however, the UK announced that it will conduct a Financial Advice Market Review to examine how financial advice could work better for consumers who are now perceived to be experiencing a shortage of access to investment advice in part because of the burdens imposed by those reforms.

If enacted, H.R. 1090, the "Retail Investor Protection Act" ("RIPA"), would stay the Department of Labor fiduciary duty rulemaking process until the Securities and Exchange Commission ("SEC") has reported to Congress regarding whether the imposition of new duties and obligations is advisable and until the SEC has had the opportunity to issue any such rules if it concludes that it is advisable.

Moreover, the one issue the Department of Labor cannot rectify unilaterally is the disharmony that its proposal will create between investments sold through Individual Retirement Accounts and those sold outside of the retirement context; only the SEC can issue rules that would impose a uniform standard in both contexts. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple

complex and potentially contradictory compliance regimes, none of which would advance any legitimate public policy objectives. Any SEC rules that are issued necessarily will cover the sale of all securities-based products while the DOL rules jurisdictionally are limited to those sold only through employer retirement plans or Individual Retirement Account vehicles.

We understand that the Department is operating within the jurisdiction of ERISA while the SEC's actions are governed by Dodd-Frank and the Investment Advisors Act. These are different statutes with different goals and parameters. It is, nevertheless, imperative that these differing statutory approaches accommodate each other or retirement savers will pay the price for confusing, potentially contradictory rules. Because the SEC's jurisdiction is broader, especially in the context of IRAs, it makes sense for the SEC to start the process of regulatory modification.

For these reasons, NAIFA supports RIPA.

IF THE DEPARTMENT PROCEEDS WITH ITS RULEMAKING, IT SHOULD RE-PROPOSE THE RULES BEFORE ISSUING FINAL RULES

By imposing a wide range of new administrative requirements along with a "best interest" standard that invites litigation regarding what satisfies that standard, the proposal implicitly favors a fee-for-service model that does not work for most Americans of modest means. The Department has expressed its commitment to revising the proposal to address many of the identified concerns, but they do not appear to intend to issue a re-proposed rule meaning that we will not receive a clean opportunity to fix issues that inevitably will arise when revisions of this magnitude are made. At a minimum, we hope that the Members of these Subcommittees will encourage the Department to provide interested parties—both within the financial services industry and among the consumers who will be most impacted by the new rules—an opportunity to review the changes the Department says it will make as a result of what it acknowledges has been helpful and important stakeholder input to date. The extent of the changes the Department itself says it will make suggest that a re-proposal (or some other form of pre-finalization review and opportunity for input) will be crucial to the possibility of a workable rule that indeed would serve the best interests of retirement savers.

CONCLUSION

The Department of Labor's proposed "fiduciary duty" rules present complex challenges to advisors and their clients. Thank you for giving us the opportunity to outline our views on these important issues and to present our concerns. I welcome the opportunity to address any questions you may have.

Exhibit 1

Commission-based

versus

Fee-based

Arrangements

		COMMISSION - A SHARE				FEE BASED EXAMPLES			
	New $ In	EOY Balance	Upfront 5.75% on New Money*	Portion of 12b1 fee broker receives to service acct .25%	Total broker fees paid each year	EOY Balance	Fee Based Acct 1.5% AUM**	EOY Balance	Fee Based Acct 1.2% AUM**
Year 1	$ 1,200	$ 1,215.00	$ 69.00	$ 3.04	$ 72.04	$ 1,266.00	$ 18.00	$ 1,269.60	$ 14.58
Year 2	$ 1,200	$ 2,515.05	$ 69.00	$ 6.29	$ 75.29	$ 2,535.63	$ 38.03	$ 2,543.24	$ 30.52
Year 3	$ 1,200	$ 3,906.10	$ 69.00	$ 9.77	$ 78.77	$ 3,875.09	$ 58.13	$ 3,890.74	$ 46.69
Year 4	$ 1,200	$ 5,394.53	$ 69.00	$ 13.49	$ 82.49	$ 5,288.22	$ 79.32	$ 5,316.41	$ 63.80
Year 5	$ 1,200	$ 6,987.15	$ 69.00	$ 17.47	$ 86.47	$ 6,779.07	$ 101.69	$ 6,824.76	$ 81.90
Year 6	$ 1,200	$ 8,691.25	$ 69.00	$ 21.73	$ 90.73	$ 8,351.92	$ 125.28	$ 8,420.60	$ 101.05
Year 7	$ 1,200	$ 10,514.64	$ 69.00	$ 26.29	$ 95.29	$ 10,011.28	$ 150.17	$ 10,108.99	$ 121.31
Year 8	$ 1,200	$ 12,465.66	$ 69.00	$ 31.16	$ 100.16	$ 11,761.90	$ 176.43	$ 11,895.31	$ 142.74
Year 9	$ 1,200	$ 14,553.26	$ 69.00	$ 36.38	$ 105.38	$ 13,608.80	$ 204.13	$ 13,785.24	$ 165.42
Year 10	$ 1,200	$ 16,786.98	$ 69.00	$ 41.97	$ 110.97	$ 15,557.28	$ 233.36	$ 15,784.78	$ 189.42
Year 11	$ 1,200	$ 19,177.07	$ 69.00	$ 47.94	$ 116.94	$ 17,612.94	$ 264.19	$ 17,900.30	$ 214.80
Year 12	$ 1,200	$ 21,734.47	$ 69.00	$ 54.34	$ 123.34	$ 19,781.65	$ 296.72	$ 20,138.52	$ 241.66
Year 13	$ 1,200	$ 24,479.88	$ 60.00	$ 61.20	$ 121.20	$ 22,069.64	$ 331.04	$ 22,506.55	$ 270.08
Year 14	$ 1,200	$ 27,417.47	$ 60.00	$ 68.54	$ 128.54	$ 24,483.47	$ 367.25	$ 25,011.93	$ 300.14
Year 15	$ 1,200	$ 30,560.70	$ 60.00	$ 76.40	$ 136.40	$ 27,030.06	$ 405.45	$ 27,662.62	$ 331.95
Year 16	$ 1,200	$ 33,923.94	$ 60.00	$ 84.81	$ 144.81	$ 29,716.71	$ 445.75	$ 30,467.06	$ 365.60
Year 17	$ 1,200	$ 37,522.62	$ 60.00	$ 93.81	$ 153.81	$ 32,551.13	$ 488.27	$ 33,434.15	$ 401.21
Year 18	$ 1,200	$ 41,373.20	$ 60.00	$ 103.43	$ 163.43	$ 35,541.44	$ 533.12	$ 36,573.33	$ 438.88
Year 19	$ 1,200	$ 45,493.33	$ 60.00	$ 113.73	$ 173.73	$ 38,696.22	$ 580.44	$ 39,894.58	$ 478.73
Year 20	$ 1,200	$ 49,901.86	$ 60.00	$ 124.75	$ 184.75	$ 42,024.51	$ 630.37	$ 43,408.46	$ 520.90
TOTAL	$ 24,000		$ 1,308.00	$ 1,036.54	$ 2,344.54		$ 5,527.15		$ 4,521.39

Assumes $1200 annual deposit earning 7% (net of mutual fund fees).

*Broker doesn't receive all of this. Some goes to fund family and some to broker dealer. Upfront sales charge is also reduced by breakpoints.

**Most broker dealers have a platform fee of .20%. So the broker receives 1.3% or 1% in these examples.

National Association of Insurance and Financial Advisors

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July 21, 2015

VIA ELECTRONIC FILING – www.regulations.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department") proposed definition of fiduciary "investment advice" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[1]

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

BACKGROUND & EXECUTIVE SUMMARY

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[2] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

[1] NAIFA has filed a separate comment letter on the Department's proposed prohibited transaction exemptions, which is attached hereto as Exhibit 1.

[2] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Many of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of conducting their business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in more detail below, NAIFA has significant concerns about the workability of some portions of the Department's proposed rule, and recommends several adjustments to the proposal. Namely, NAIFA strongly encourages the Department to adopt a final fiduciary investment advice definition that:

- Requires some investor reliance on the investment advice;
- Requires a mutual understanding between the investor and the advisor;
- Excludes referrals to other financial professionals;
- Excludes distribution-related advice that is not investment advice;
- Excludes welfare benefit plans with no investment component;
- Excludes, or includes a carve-out for, marketing and sales activity for all products, services and investors;
- Includes a carve-out for advice relating to employer plan design;
- Allows for meaningful investor education by including a broad education carve-out;

- Allows advisors to place reasonable limitations on the scope and duration of the fiduciary relationship; and
- Includes an enforcement timeline of at least thirty-six months.

In its current form, the proposed rule presents major—and in some cases, insurmountable—obstacles for NAIFA members serving middle-market retail investors (i.e., those who need the most encouragement and assistance when it comes to retirement savings). NAIFA hopes that the objective of the Department's proposal is not to limit or take away advisory services for Main Street investors, and we greatly appreciate your thoughtful consideration of these comments.

I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[3] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[4] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[5] Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[6]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed

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[3] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[4] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[5] *Id.*

[6] *Id.*

rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[7] And small businesses that work with a financial advisor are 50%

[7] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[8] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[9] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[10]

B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
>
> (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
>
> (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets

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Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

[8] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 2.

[9] Oliver Wyman Study, at 6.

[10] LIMRA Survey, at 13.

they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[11] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[12] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and

[11] Oliver Wyman Study, at 6.

[12] *Id.*, at 7.

dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[13] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

[13] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

II. THE PROPOSED RULE

Virtually all NAIFA members will be investment advice fiduciaries for purposes of ERISA and the Code under the Department's proposed rule. The rule, along with the Department's proposed PTEs, will require major changes in our members' business practices and client relationships. While NAIFA is not opposed to a "best interest" standard of care for advisors, it is extremely important that such a standard be contained within a feasible operational structure.

As it stands, nearly all of our members who become fiduciaries will have to alter their current compensation arrangements (for at least some clients and some products) or satisfy a PTE. For the reasons discussed above, both options carry significant risk of harm to retail investors. We believe that such risk can be partially mitigated, however, if the Department addresses the specific points of concern discussed below.[14]

A. Scope of the Proposed Definition of Fiduciary "Investment Advice"

1. *The definition of fiduciary investment advice should require some investor reliance on the investment advice.*

The Department's current five-part test for fiduciary investment advisors includes a requirement that the advice serve as the primary basis for the investment decision(s) ultimately made by the investor.[15] The requirement ensures that clients actually act on the investment advice before a fiduciary relationship arises. NAIFA strongly urges the Department to maintain a similar reliance requirement under its proposed definition of fiduciary investment advice. Otherwise, advisors are forced to take on a fiduciary role, even if their investment advice is completely

[14] Again, NAIFA has submitted separate detailed comments on suggested adjustments to the Department's PTE proposals.

[15] *See* 29 CFR 2510.3-21.

ignored or has no impact whatsoever on the client's investment decisions. Given the substantial cost and burden on fiduciaries under the Department's proposal, fiduciary relationships should at least be limited to situations in which some meaningful advice or service is rendered *and* accepted.

2. *The definition of fiduciary investment advice should require a mutual understanding between investor and advisor.*

Similarly, the Department's current fiduciary investment advice test includes a requirement that the advice be given pursuant to a mutual agreement or understanding between the investor and the advisor.[16] Mutual understanding, like reliance, should be an element of the Department's new definition of fiduciary investment advice. Before a fiduciary relationship exists, both parties should, at a minimum, recognize that the advice is being given and considered for the client's particular investment needs. Without such mutuality, casual or social conversations could be misconstrued as fiduciary communications. Again, considering the burden of the overall fiduciary structure proposed by the Department, some common-sense checks should be in place before fiduciary obligations are imposed on advisors. At the very least, the impacted parties should have an awareness and understanding of what they are undertaking.

3. *Recommendations of other financial professionals should not fall within the definition of fiduciary investment advice.*

As drafted, the Department's proposed definition of fiduciary investment advice covers four general categories of advice:

> (1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including a recommendation to rollover assets or take a distribution);
>
> (2) A recommendation as to the management of securities or other property (again, including rollover and distribution decisions);
>
> (3) An appraisal, fairness opinion, or similar statement—verbal or written—concerning the value of securities or other property when provided in connection with a specific transaction; and
>
> (4) A recommendation of a person who is also going to receive a fee or other compensation for providing the aforementioned types of advice.

The last category—recommendations of other financial professionals—should be excluded from the fiduciary investment advice definition because it is not *investment* advice. In fact, a simple referral is several steps removed from actual investment activity. The Department's definition appears to assume that the recipient of the advice will in fact pursue the recommended professional, that the other professional to whom the prospective client is referred will be in a position (and agree) to work with the client, and that investment advice will actually be given and acted upon.

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[16] *Id.*

Furthermore, inclusion of referrals under the new definition of fiduciary investment advice will effectively eliminate referrals because advisors simply will not be willing to take on fiduciary obligations in situations where the "advice" rendered is to send the investor elsewhere for services. And reducing referrals will harm investors. Professional referrals are a valuable service, particularly to unsophisticated investors or those who are new to retirement planning and saving. A list of names or advertisements in a phone book does not offer any meaningful guidance for investors to narrow down their options or find professional services that are suitable for them. Referrals from individuals in the same business, however, provide investors with some confidence that they will be talking to a reputable advisor who, in at least someone's estimation, is an appropriate advisor for the investor.

The Department's proposal to include referrals in the definition of fiduciary investment advice defies logic and will only harm consumers. Accordingly, the Department should remove this category of advice from the proposed definition.

4. *Advice regarding distributions—without accompanying investment advice—should not be included in the definition of fiduciary investment advice.*

As noted above, the Department proposes to include advice regarding distributions under the definition of fiduciary investment advice. This type of advice should be excluded, however, when it is rendered without any accompanying *investment* advice. For example, if an advisor is informed that an investor has suffered an unforeseeable financial loss and needs to take a hardship distribution—and there is no investment recommendation sought or given pertaining to the distributed funds—the advisor's non-investment advice aimed at facilitating the distribution should not qualify as fiduciary investment advice. Similarly, if an advisor counsels an investor not to take a distribution (i.e., to preserve the status quo with respect to plans and assets), that also should not be considered fiduciary advice.

In these scenarios, the advisor is not delivering advice with respect to particular investments from which the advisor may benefit, but rather is providing generic counseling and assistance for the good of consumers. Thus, the Department should clarify in the final rule that such distribution-related advice is not considered fiduciary investment advice.

5. *Welfare benefit plans with no investment component should be excluded from the rule.*

The Department's proposed rule defines "plan" as "any employee benefit plan described in section 3(3) of [ERISA] and any plan described in section 4975(e)(1)(A) of the Code." Section 3(3) of ERISA includes employee pension benefit plans and employee welfare benefit plans, which include health, life, and disability benefits. Department officials indicated at a meeting on May 20, 2015, and during a phone conversation on June 3, 2015, that the Department does not intend the proposed rule to cover welfare plans that do not have an investment component (i.e., plans that are not designed to generate income or increase wealth). NAIFA strongly urges the Department to clarify in its final rule that benefit plans like traditional health, life and disability are not covered under this rule-making.

NAIFA suggests achieving such clarification by adding a definition of "other property." For example, the definition could read:

> "'*Other property*' for purposes of this section does not include welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

Alternatively, the term "investment" could be defined as follows:

> "'*Investment*' for purposes of this section does not include the purchase, sale, holding, or exchanging of welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

In addition to these specific suggestions, there may be other ways for the Department to resolve this issue. NAIFA urges the Department to clarify, in one way or another, that welfare benefit plans with no investment component are not covered under this rule-making.

6. *Marketing of services and preliminary client development conversations should not be considered fiduciary investment advice.*

For the individuals and small businesses served by NAIFA members, effective marketing of our advisors' services can mean the difference between an employer offering a retirement plan or not, or an individual prematurely cashing out a retirement account or continuing to save. Getting good advice to consumers who need it is a goal we all share. Further, as discussed above with respect to professional referrals, we all agree that consumers should be able to make informed decisions when choosing their advisors.

Department officials said at a technical briefing on May 7, 2015 that they did not intend to capture conversations along the lines of "hire me" or "these are the services I can offer you" under the definition of investment advice. At that same briefing, officials acknowledged that there should be some opportunity for preliminary conversations with prospective clients before fiduciary status and any attendant contract or disclosure requirements are triggered. Secretary Perez echoed those comments while testifying before a congressional committee on June 17, 2015, where he stated that the Department wants consumers to be able to "shop around" and "[the Department's] goal is to make sure that shopping around can happen." However, given some elements of the proposed rule, NAIFA believes that these sentiments need to be clarified and memorialized in any final rule.

As drafted, the proposed rule applies to a recommendation:

> (1) of a person who is going to receive compensation for providing investment advice;
>
> (2) that is individualized or specifically directed to the recipient of the recommendation; and

(3) is provided by someone who may eventually receive compensation as a result of the recommendation.[17]

It appears that this would cover one-on-one sales pitches and targeted advertising by advisors seeking to introduce their services to new clients, which creates an unnecessary barrier to services for individuals and employers who will not sift (or do not feel comfortable sifting) through anonymous advisor listings in the phone book.

The Department could ensure that these initial conversations are not captured by adopting some of the above suggestions (e.g., by requiring some investor reliance and mutual understanding between advisors and investors). Or, as discussed in detail below, the Department could resolve this issue by creating a robust seller's exception. Regardless of the approach taken, NAIFA urges the Department to carve out marketing and preliminary conversations with prospective clients from the investment advice definition.

B. The Department should Adopt a Seller's Exception that Applies Across all Products, Services, and Investors.

The Department's proposed seller's exception (the counterparty carve-out) does not apply to small plans or IRAs at all, and is limited to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract to large plan ("sophisticated") investors.[18] As drafted, the exception also does not appear to cover a discussion about an advisor's services.[19] The Department should replace its proposed counterparty carve-out or create a separate seller's exception that applies to all products, services, and investors.

A robust seller's exception will allow advisors and financial institutions to market their products and services. Marketing, as opposed to true investment advice, poses very little threat of conflicts of interest. Presumably, this is why marketing has not historically been considered fiduciary activity under ERISA or the Code. Indeed, it is unclear whether the Department has statutory authority to capture pure marketing and sales activities under the fiduciary umbrella.

Sales pitches in the financial advisor context are like sales pitches in all other retail contexts; they are take-it-or-leave-it promotions designed to attract consumers in the first instance so that products and services can *then* be delivered. And like other retail contexts, financial advisor marketing should not be limited to certain segments of the population. The Department appears to believe—without apparent justification—that small business owners (i.e., with 99 or fewer employees) are not as sophisticated as large business owners (i.e., with 100 or more employees).

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[17] *See* proposed § 2510.3-21(a)(1)(iv) (what constitutes investment advice), (a)(2)(ii) (the requirement that said advice be directed to an individual), and (f)(6) (definition of "fee or other compensation, direct or indirect").

[18] *See* proposed § 2510.3-21(b)(1)(i).

[19] Because the counterparty exception applies only to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract, it is NAIFA's interpretation that it does not cover a discussion of services.

Size of a business is immaterial, however, to the financial knowledge and sophistication of a plan fiduciary. Furthermore, there is no evidence that financial sophistication is needed to understand when someone is making a sales pitch rather than delivering impartial advice. The Department's paternalistic approach is misguided, and will only prevent a large number of consumers from learning about available products and services, which is counterproductive for the retirement crisis in this country.

Any seller's exception could and should include reasonable investor protections, such as clear and explicit disclosures by the advisor that she is not providing impartial or fiduciary investment advice (i.e., the disclosure required under the proposed counterparty exception), but rather is engaged in marketing or sales activity. A full disclosure of this nature supports the Department's objective of improving consumer awareness of advisors' obligations (or lack thereof) in certain circumstances. At the same time, a broad exception allows for effective marketing and client development, which will help advisors reach those populations that are arguably in most need of professional retirement planning assistance.

C. The Final Rule Should Include a Carve-Out for Advice on Plan Design.

An advisor's assistance to employers with menu design for participant-directed plans (including 401(k) plans, SIMPLE IRAs, and SEP IRAs) should be excluded from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products.[20] Thus, the risk of a conflict of interest arising at this stage between the advisor and employee investors is minimal. Furthermore, in the plan design space, the plan administrator—regardless of plan size—*is* under a separate obligation to make informed and prudent decisions with respect to the plan.[21]

The "plan design exception" should apply when an advisor is providing recommendations to an employer:

> (1) On the types of retirement plans available (e.g., 401(k), SIMPLE IRA, etc.), and associated costs and benefits with respect to plan types;
>
> (2) On the investment options that will be made available through the plan selected (e.g., mutual fund options, annuity options, etc.), including advice related to the overall allocation of investment options and advice related to narrowing down options within general product categories; and

[20] NAIFA recognizes that individualized investment advice to plan participants or IRA owners is a different scenario with separate conflict-of-interest concerns.

[21] *See* 29 U.S.C. § 1002(21)(a)(iii) (under ERISA, a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of such plan); *see also* 26 U.S.C. § 4975(e)(3)(C) (corresponding fiduciary definition under the Code).

(3) On plan administration topics, including selection of a managing fiduciary, third-party administrators, and other administrative service providers.[22]

Employers need professional advice in each of these areas to establish and maintain a retirement plan appropriate for their specific needs and employee populations. As explained above, a plan design exception is consistent with the Department's goal of minimizing advisor conflicts of interest, as well as the overarching objective of encouraging individuals to save early for retirement by increasing the availability of employer-sponsored retirement plans.[23]

D. The Final Rule Should Allow for *Meaningful* Investment Education.

During a meeting on May 4, 2015 with NAIFA members, Department officials stated that one of their objectives is to preserve investor education. And Secretary Perez told members of Congress on June 17 that investor education is "exceedingly important." Unfortunately, the narrow scope of the education exception under the proposed rule will not facilitate the goal of preserving or expanding investor education. It will have the opposite result, especially for unsophisticated investors who benefit the most from such education.

Secretary Perez commented on June 17 that, in his view, the "most important part" of an educational discussion between advisor and investor "is the asset allocation conversation." And, he asserted that, under the proposed rule, those conversations do not trigger fiduciary status or obligations. The Secretary's comment is perplexing, to say the least, when one reads the proposal's narrow education exception.

There are approximately 9,000 mutual funds available today, not to mention the host of other types of products available in the retirement space. Telling an inexperienced investor to choose among mutual funds without providing any guidance as to the strength or desirability of any particular funds is not meaningful education; it is simply overwhelming. Meaningful education requires some identification and characterization of specific investment options.

The Department has not historically restricted "education" to generic, high-level conversations. Instead, the Department has allowed for meaningful education to take place, with appropriate disclosures. For instance, under Interpretive Bulletin 96-1,[24] the Department has not included within fiduciary "investment advice" asset allocation models that identify specific investment

[22] We do not interpret the Department's proposed platform provider carve-out to be broad enough to capture these advisor services. To the extent the Department does intend for the carve-out to cover these activities, NAIFA urges the Department to make that clear in the final rule.

[23] Alternatively, if the Department chooses not to include a plan design exception, NAIFA urges the Department to finalize a more robust PTE 84-24 that would cover plan design services and advice. This alternative approach is described in more detail in NAIFA's comment letter on the Department's proposed PTEs, attached hereto as Exhibit 1.

[24] 29 CFR Part 2509.

alternatives, as long as they are accompanied by a statement indicating that other investment options with similar characteristics may be available. Bulletin 96-1 reasons: "Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a "recommendation". . . and, accordingly, would not constitute [fiduciary investment advice]."[25]

The Department's rationale in Bulletin 96-1 makes perfect sense and its approach strikes an appropriate balance between ensuring the availability of meaningful investment education and providing investor protection. NAIFA strongly encourages the Department to maintain its current rule on investment education and create an education exception under its proposed rule that encompasses this broader, more helpful approach.

E. Advisors Should be Permitted to Put Reasonable Limitations on the Scope and Duration of the Fiduciary Relationship.

Department officials stated at the May 7, 2015 technical briefing that they do not intend the proposal's prohibition on exculpatory contractual language[26] to prohibit advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the time period and scope of services the advisor is willing to provide to a given client). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) regarding the expiration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail the provision of ongoing advice (e.g., a one-time sale relationship), the advisor should be able to make clear that the fiduciary relationship concludes with the sale and the advisor does not have perpetual fiduciary obligations to the client.[27] NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a disclosure to the client.

III. The Department Should Extend the Enforcement Timeline to at least Thirty-Six Months

The eight-month enforcement timeline for compliance with the new rule proposed by the Department is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about

[25] *Id.*

[26] *See* Proposed BIC Exemption, Section II(f)(1).

[27] A contractual term of this nature would not bar suit by the investor based on breach of fiduciary duty or interfere with any current statutes of limitation with respect to such claims.

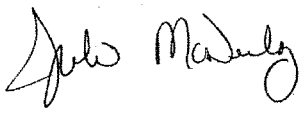
the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

Each one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

Very truly yours,



Juli Y. McNeely, LUTCF, CFP, CLU
NAIFA President 2014-2015

Exhibits: NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions
LIMRA Secure Retirement Institute 2015 Consumer Survey

Exhibit 1

NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions

National Association of Insurance and Financial Advisors

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RE: RIN 1210-ZA25 - Proposed Prohibited Transaction Exemptions D-11712 (Best Interest Contract Exemption) and D-11850 (PTE 84-24)

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department" or "DOL") proposed prohibited transaction exemptions ("PTEs") under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[1]

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

BACKGROUND & EXECUTIVE SUMMARY

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[2] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

[1] NAIFA has filed a separate comment letter on the Department's proposed definition of fiduciary "investment advice," which is attached hereto as Exhibit 1.

[2] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in further detail below, some of our members' existing compensation arrangements do not violate ERISA or Code prohibited transaction rules, and therefore do not require compliance with a PTE.[3] To the extent NAIFA members must rely on PTEs, however, we have serious concerns about compliance burdens under the Department's proposal, particularly with respect to the Best Interest Contract ("BIC") Exemption and the proposed revisions to PTE 84-24.

Despite Secretary Perez's statement before Congress on June 17, 2015 that the Department's proposal makes things "simpler" by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed PTEs are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

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[3] Diagrams of common compensation arrangements for advising employers on plan design (employer plan model) and for the sale of fixed and variable annuities (annuity models) are attached hereto as Exhibits 2(a) and 2(b), respectively.

Accordingly, NAIFA recommends that the following revisions be made to the proposed BIC exemption and PTE 84-24:

Best Interest Contract Exemption -

- Simplify and clarify the exemption's requirement to the greatest extent possible in order to avoid litigating areas of uncertainty;
- Align the exemption's conditions as closely as possible with existing SEC requirements to avoid a dual regulatory system for securities products;
- Hone the "best interest" definition to account for varying perspectives and opinions on particular investment products and business practices; specifically:
  - Refine the "prudent person" term by, for example, expanding the clause to reference a "prudent person serving clients with similar retirement needs and offering a similar array of products;"
  - Provide a clear and explicit statement that offering products on which there are varying opinions within the industry (e.g., variable annuities) does not violate the best interest standard; and
  - Provide a clear and explicit statement that offering proprietary products (even a limited suite of such products) does not violate the best interest standard;
- Clarify that the exemption covers rollovers and distributions (to the extent those activities are considered fiduciary investment advice);
- Modify the contract conditions, specifically:
  - Eliminate the formal contract requirement and replace it with a non-signatory point-of-sale notice that binds advisors and financial institutions to act in the best interest of their clients;
  - Or, if the Department retains the contract requirement, clarify:
    - that any contract need not be signed prior to the point of sale;
    - that the contract need not be signed by more than one financial institution;
    - that advisors do not have to provide warranties regarding another entity's (e.g., a financial institution) incentive and compensation arrangements;
    - that the contract may contain language reasonably limiting the scope and duration of the fiduciary relationship;
- Lessen advisors' disclosure obligations, particularly to the extent they conflict with securities laws or involve information that is not readily accessible to individual advisors;
- Clarify that non-securities licensed advisors can satisfy the best interest standard; and
- Explain and clarify the interplay between the special exemption for insurance and annuity products, the larger BIC exemption, and other available PTE relief.

Proposed PTE 84-24 –

- Expand the scope of the PTE to cover all annuity products sold to all types of investors;
- Do not revoke the PTE for SIMPLE and SEP IRA purchases of variable annuities and mutual funds; and

- Expand the PTE's compensation relief to be coextensive with the BIC exemption, or at the very least, to allow agent commissions for mutual fund sales.[4]

Below is a detailed discussion of the foreseeable impact of the Department's proposal, as drafted, and the aforementioned recommendations to make the proposal less onerous.

I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[5] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[6] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[7] Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[8]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by

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[4] To the extent PTE 84-24's proposed conditions are the same as those under the BIC exemption, NAIFA's comments with respect to those conditions apply to both exemptions.

[5] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[6] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[7] *Id.*

[8] *Id.*

making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[9] And small businesses that work with a financial advisor are 50%

[9] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[10] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[11] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[12]

B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
>
> (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
>
> (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a

[10] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 3.

[11] Oliver Wyman Study, at 6.

[12] LIMRA Survey, at 13.

given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[13] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[14] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

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[13] Oliver Wyman Study, at 6.

[14] *Id.*, at 7.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[15] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for

[15] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

II. THE DEPARTMENT SHOULD CLARIFY THAT SOME FEE ARRANGEMENTS DO NOT REQUIRE COMPLIANCE WITH A PROHIBITED TRANSACTION EXEMPTION

A. Non-Variable, Negotiated Fees Paid by the Client should not Trigger PTE Compliance Requirements

ERISA and Code prohibited transaction rules generally bar fiduciaries from receiving compensation that varies based on the investment advice given or the investment choice made by the investor, as well as compensation from third parties. Flat fee arrangements and other non-variable compensation (e.g., wrap accounts), however, are permitted.[16] Thus, some of our members' existing compensation models should not violate the prohibited transaction rules or trigger any obligation to comply with a PTE.[17]

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[16] *See* ERISA §§ 406 and 408b-2(e); DOL Frost Advisory Opinion (97-15A) (May 22, 1997); DOL Field Assistance Bulletin 2007-1 (Feb. 2, 2007).

[17] NAIFA explains in its comment letter on the Department's proposed rule that advice to employers on plan and menu design (irrespective of plan type) should be excluded entirely from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising at this stage between the advisor and the employee investors is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved. The arguments in this letter are presented as alternatives, in the event the Department decides not to grant a carve-out for these services from the definition of fiduciary investment advice.

For instance, many NAIFA members advise employers, under a negotiated fee arrangement[18], on how to set up employee retirement plans. Our members' services include analysis of the employer's specific needs, recommendations related to general plan models (e.g., 401(k), SIMPLE IRA, etc.), and advice about the investment options that are offered through the plan (e.g., particular mutual funds or annuity products). These services generally are provided on a fee basis.

The advisor's fee is negotiated in advance with the client (the employer), and is usually expressed as a percentage of assets held in the plan (i.e., basis points).[19] The fee amount is invoiced through the advisor's broker-dealer (or, in the case of a group annuity product, through the insurance carrier).[20] Once the fee is remitted, the financial institution forwards the advisor's compensation to her. Notably, the advisor's fee amount *does not vary* based on the plan type or investment options selected by the employer. Although the fee is invoiced through the financial institution, the advisor's compensation comes from the employer. The advisor does not receive any other compensation (e.g., trailers, revenue sharing, etc.) from the employer or any third parties for these services.

Some advisors employ this same fee model to advise individual employees on their investment choices within the plan. In such instances, the employer's fee package covers this service for the employees. Again, the advisor's compensation does not vary based on the investment options selected by the employee, and the advisor does not receive any additional compensation from any source for these services.

Similarly, NAIFA members help employers set up SIMPLE and SEP IRAs for their employees. These plans are especially appealing to small employers because they are far less burdensome to administer than traditional 401(k) pension plans. Our advisors provide the same services to employers who choose to offer SIMPLE and SEP IRAs as those described above with respect to setting up a 401(k) plan (i.e., discussing and evaluating plan design options, and narrowing down the options to be offered through the plan). And the same fee structure generally applies, regardless of whether the employer chooses to offer a 401(k) plan or a SIMPLE or SEP IRA (i.e., non-variable fee based on percentage of assets in the plan, negotiated with the employer, invoiced through the financial institution).[21]

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[18] This fee arrangement—the employer plan model—is diagramed in Exhibit 2a.

[19] Notably, our Members are often in a competitive bidding process with other advisors for these employers' business. Thus, our advisors are incentivized to keep costs as low as possible for the employer.

[20] We note that this invoicing step (i.e., billing through a broker-dealer or carrier) creates some confusion in terminology under state law. Some states label any compensation that is billed through a third party a commission, not a fee. However, this pure invoicing function should not create concern for the Department under the ERISA and Code prohibited transaction rules.

[21] SIMPLE and SEP IRAs can differ from plans when it comes to compensation for advising individual employee participants. In some cases, compensation for employee-level advice under a SIMPLE or SEP IRA is done on a commission basis (similar to traditional compensation

Fees paid by employers for plan design services (for all plan types) are negotiated between the advisor and the client and are either a set dollar amount or a percentage of total assets under management. Although the fees are invoiced through a financial institution, they are paid by the client, not a third party. The fees do not vary based on the plan type or investment options selected by the employer. In some cases, the employer's fee also covers advice to individual employees regarding their investment options under the plan. The Department should clarify that this type of fee arrangement for fiduciary investment advice—whether the advice is given to the employer or the individual employees—is permitted under the current rules and does not require compliance with a PTE.

B. Upstream Conflicted Compensation should not Trigger PTE Compliance Requirements for Advisors

In general, NAIFA encourages the Department to divorce conflict-of-interest concerns at the advisor level from those at the broker-dealer or carrier level. Our members often are not aware of the compensation arrangements for carriers and broker-dealers. Furthermore, compensation at the broker-dealer or carrier level, in many circumstances, has no impact at all on an advisor's investment advice or the advisor's compensation for that advice.

For example, in the plan design scenario described above, our members receive a flat, negotiated fee for services, and their compensation does not vary based on how the client reacts to the investment advice given. Thus, regardless of upstream compensation arrangements, there is no conflict at the advisor level. The Department should clarify that so long as the advisor's own compensation does not violate the prohibited transaction rules, the advisor does not need to comply with an exemption.

III. BEST INTEREST CONTRACT EXEMPTION ("BIC")

Secretary Perez and Department officials have stated on several occasions that the objective of the proposed PTEs—particularly the BIC exemption—is to create an enforceable "best interest" fiduciary standard.[22] The Department has professed flexibility, however, regarding how such a standard is operationalized. NAIFA does not oppose the Department's overall goal; in fact, our members believe that they already satisfy a best interest standard.

NAIFA has significant concerns though about the onerous, costly nature of the proposed BIC exemption (upon which the vast majority of our members will have to rely, due to the clients we serve). Despite the Department's repeated characterization of the proposed exemption as "principles-based" and flexible, the proposal is in fact highly prescriptive. Its effect, as drafted,

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arrangements for mutual fund sales) and is not directly negotiated with or paid by the employer. We recognize that for advisors to continue to receive this compensation for employee-level advice, they will have to comply with a PTE.

[22] *See, e.g.*, Comments of Secretary Perez, hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

will be to drive all advisors and financial institutions to a uniform business model with flat-fee compensation arrangements and unnecessarily formalized and burdensome advisor-client interactions, none of which suits small account holders or unsophisticated investors. For all of the reasons discussed previously in this comment letter, advisory fee-based compensation models are not appropriate or desirable for small account holders, and the dramatic increase in the cost of doing business under the proposed PTEs will substantially increase costs for clients under traditional brokerage-account compensation arrangements.

Furthermore, the BIC exemption's contract requirement portends a substantial increase in litigation and penalty exposure for advisors, especially those advising IRA owners. To the extent *any* of the exemption's requirements are unclear under the final rules, litigation will likely ensue. For instance, the "best interest" standard, as proposed, is open to different interpretations even among industry professionals (discussed more fully below), and is therefore ripe for consumer lawsuits. In addition to the increased threat of litigation, advisors will also face substantial risk of excise tax penalties under the Code as they navigate and implement a brand new compliance regime.[23] A high level of litigation and penalty exposure will increase the cost of doing business for advisors and financial institutions, and in some cases, the amplified risk will cause services to disappear for middle market clients. Thus, NAIFA strongly prefers that the Department finalize a clear, simple BIC exemption, rather than rely on the courts to define the contours of the rule through costly litigation over the span of several years.

Compounding the difficulty with the BIC exemption is the fact that, for securities products, it sets up a dual regulatory regime with the SEC. In every instance where the exemption differs from the SEC's requirements—in the timing and content of disclosures or a brand new contract requirement, for example[24]—advisors and financial institutions will be faced with an extra layer of compliance burden. Therefore, it is important for the Department to finalize the exemption's conditions in such a way that they correspond with or can be incorporated into existing regulatory requirements. Cohesion between regulatory systems will significantly mitigate cost increases and decrease confusion for advisors and consumers.

In general, eliminating or minimizing complexity and uncertainty under the BIC exemption (to the greatest extent possible) will help advisors and investors in the long run by establishing comprehensible obligations and expectations, by limiting litigation risk and expense, and by avoiding excessive regulatory burdens. NAIFA recommends that the Department simplify the BIC exemption's requirements and offers the following specific recommendations for streamlining the proposal.

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[23] The Code currently gives advisors a 14-day correction period in which to correct a transaction that violates certain Code prohibited transaction rules and avoid an excise tax penalty. 26 U.S.C. §§ 4975(d)(23) and (e)(11)(A). Given the complexity of the Department's proposal and the substantial differences between it and the current rules, NAIFA encourages the Department to consider implementing an extended correction period so that advisors have sufficient opportunity to identify and fix any inadvertent errors during this transition period.

[24] *See, e.g.,* SEC disclosure requirements for clients and prospective clients, 17 CFR 275.204-3 (Delivery of Brochures and Brochure Supplements); *see also* Part 2 of Form ADV.

A. The "Best Interest" Standard Should Be Refined to Take into Account Varying Perspectives and Opinions on Investment Products and Business Practices

We all agree that advisors should act in the best interest of their clients. It is important, however, that the concept of "best interest" not be conflated with "best performance." It is equally important not to confuse "best interest" with "least expensive."

A Principal Funds chart attached hereto as Exhibit 4 shows the volatility in asset class performance between 1994 and 2013. The best- and worst-performing assets change constantly. Because no one can predict the future, diversification is essential to any investment strategy. Further, not all investment products are created equal—the quality and level of risk of different products can vary dramatically. And of course, clients' needs differ and fluctuate widely. Thus, in many instances, an appropriately diversified, high-quality, individually-tailored investment portfolio will not include the least costly products; and yet, given the multitude of factors to consider, such a portfolio is in the client's best interest. To the extent the Department's best interest standard takes into account individualized needs and considerations, and does not turn on performance or cost, it has NAIFA's full support.

One element of the Department's proposed best interest standard does concern us, however. Under the Department's proposal, advice is in the best interest of the investor when the advisor (and financial institution):

> acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the [investor], without regard to the financial or other interests of the [advisor or her affiliates].[25]

NAIFA encourages the Department to refine the meaning of "prudent person" within this definition.

The retirement planning industry includes diverse advisors who serve diverse clients and deal in a broad array of products. As a result, there always will be disagreement in the industry about the wisdom or desirability of certain approaches or certain products. For example, there is controversy within the industry about the utility and desirability of variable annuity products. There may also be disagreement among industry professionals about captive advisors offering clients a limited suite of proprietary products (i.e., an industry bias toward independent reps over captives).

Despite these differences in opinion, however, these products and approaches are valuable to investors. Indeed, investors *want* them or they would not be offered. Variable annuities, for instance, provide some investors with a much-needed income stream for life, and may be attractive for their upside potential and tax structure, and proprietary products provide consumers with well known, high-quality investment options (often through local Main Street advisors). Ultimately, consumers should be able to choose from a broad range of investment options (and a range of professional advisors) because there is no "one size fits all" in this context.

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[25] Proposed BIC Exemption, Section VIII(d).

NAIFA recommends that the Department take three steps to account for intra-industry differences like these and to preserve consumer choice under the best interest standard:

> (1) refine the "prudent person" term by, for example, expanding the clause to reference a "prudent person serving clients with similar retirement needs and offering a similar array of products;" and
>
> (2) include a clear and explicit statement that offering products on which there are varying opinions within the industry (e.g., variable annuities) does not violate the best interest standard; and
>
> (3) include a clear and explicit statement that offering a limited suite of proprietary products does not violate the best interest standard.

Without such clarification, these issues will end up being litigated, generating substantial expense and confusion for advisors and investors alike. The likelihood of litigation on these points presents a direct threat to many of our members' businesses, given the large number of them who deal in annuities and proprietary products. Accordingly, it is vital that the Department hone its best interest standard to ensure it is workable across the industry and not employed to target or undermine specific products or business practices.

B. Scope of the Exemption Should Be Expanded to Cover Rollovers and Distributions

The BIC exemption currently is limited to "services provided in connection with a purchase, sale or holding" of a defined list of assets.[26] NAIFA interprets the current scope of the exemption to exclude advice and services related to rollovers, distributions,[27] and the opening of IRA accounts. Department officials stated at a technical briefing on May 7, 2015 that they do intend to cover rollovers and distributions under the BIC exemption. NAIFA encourages the Department to clarify this point by revising the provision on "covered transactions" under the BIC exemption or by broadening the definition of "asset" for purposes of the exemption.

C. Exemption Conditions

1. *The Department should not require a formal contract, but rather a non-signatory notice.*

The fundamental purpose of the BIC exemption's contract requirement, according to the Department, is to create a binding obligation—of which consumers are aware—for advisors to act in the best interest of their clients. NAIFA does not take issue with this goal. But NAIFA does encourage the Department to adopt a more tenable approach to achieving its objective.

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[26] Proposed BIC Exemption, Section I(b).

[27] NAIFA argues in its comment letter on the Department's proposed rule that distributions should not be treated as "investment advice." This argument is presented in the alternative, in the event the Department does not create such a carve-out.

Requiring a lengthy, complicated contract executed by at least three parties goes beyond what is necessary to create an enforceable obligation. It is our understanding that the Department has proposed such a requirement in order to obtain enforcement authority over IRA advisors who would otherwise only be subject to the Code's fiduciary regime. But it is unclear to us where, under ERISA or the Code, the Department has been granted authority to circumvent the statutory enforcement structure in such a way.

Instead of a formal contract, the Department should require a non-signatory notice at the point of sale, which would bind advisors and financial institutions to act in the best interest of their clients and be actionable if the standard of conduct were not met. A notice-type requirement would entail far fewer implementation challenges than a formal contract, could be effected more quickly, and would provide meaningful disclosure of the conduct standard to customers (without placing on them the burden of executing formal contracts).

To the extent the Department retains a formal contract requirement, however, NAIFA recommends the following changes in order to make any such obligation workable.

a. Any contract or notice requirement should be triggered at the point of sale and not before.

Secretary Perez and Department officials have said on multiple occasions that they do not intend to require a signed contract before preliminary conversations between an advisor and an investor. The text of the proposed exemption, however, indicates something different; specifically, it requires that a contract be in place *prior to any recommendation* by the advisor that an investor purchase, sell, or hold an asset.[28] In other words, a contract must be in place before an advisor provides a recommendation or an investor decides to rely on that recommendation in any way (or, just as likely, declines to act on it at all).

Any contract or notice requirement should be triggered by an investment *action* taken on the client's behalf (i.e., some affirmative reliance by the investor on the advice). NAIFA encourages the Department to revise its approach such that any contract requirement is tied to an actual transaction (e.g., at the point of sale or as soon as practicable after an executed transaction). A contract requirement at the conversation stage of the investor-client interaction is premature and unnecessary (because there may not even be any action taken in the best interest of the client or not in the best interest of the client), and will only stifle preliminary conversations about investors' options.

Requiring a contract prior to the point of sale presents particular problems for independent advisors selling annuity products (fixed or variable). Some of our advisors sell annuity products from dozens of insurance carriers. If a contract requirement is triggered by a simple recommendation (or, given the Department's restrictive education exception under the definition of "investment advice," any discussion of the relative merits of specific products) with respect to any of these annuity options, we could be dealing with several contracts for a single initial conversation with one client. This scenario, at least with regard to variable annuities, also raises concerns about the required signatories to the contract, which is discussed in the next section.

[28] Proposed BIC Exemption, Section II(a).

NAIFA urges the Department to also consider that it would take a substantial amount of time and resources for advisors to "paper" their existing clients (sometimes hundreds of clients for a single advisor) with new contracts. NAIFA members estimate that getting new contracts in place will require, for 77% of clients, face-to-face conversations and explanations about the new requirement. In other words, simply mailing out contracts and requesting returned signed copies is not a feasible option for the vast majority of our clients. NAIFA encourages the Department to be mindful of this reality and draft its final rule in such a way that any new contract requirement will not bring on-going services to existing clients to a complete halt while contracts are developed, circulated, explained, and signed.

Finally, the Department should consider an omnibus implementation strategy for existing clients. Specifically, the Department should allow advisors to send notices to their existing clients stating that the advisor has a fiduciary obligation to act in the client's best interest. As discussed above, such a notice would be binding on the advisor, but would mitigate the burden of obtaining signed contracts with every client. To the extent the Department retains a formal contract requirement, however, a good-faith effort to get executed contracts in place for all existing clients within a reasonable amount of time should satisfy any such requirement.

b. Only one financial institution signature should be required on any contract.

The proposed BIC exemption requires that the contract be signed by the advisor, the financial institution for which the advisor acts as agent or registered representative, and the investor. NAIFA is concerned that, under the proposed exemption, our members' contracts may require four signatories.

"Financial institution" is defined under the proposal as the entity (including a registered investment adviser, a bank, an insurance company, or a broker-dealer) that employs the advisor "or otherwise retains such individual as an independent contractor, agent or registered representative." This structure is especially problematic for variable annuity products, which have both insurance and securities features. When selling these products, our members are appointed by the insurance carrier and are registered representatives of the broker-dealer.[29]

Thus, based on our reading of the proposed BIC exemption, it appears our advisors would need to obtain signatures from both the broker-dealer and the insurance carrier each time they even *recommend* a variable annuity product. And if they recommend multiple variable annuity products, the proposal would require multiple contracts (for the same client and the same discussion), signed by the respective carriers of each recommended product, the advisor, the broker-dealer, and the investor. This simply is not a workable requirement.

Any contract requirement should be satisfied with the signature of the registered representative, her broker-dealer, and the investor, and should not have to include the carrier's signature. Requiring each carrier's signature portends an excessively burdensome process. Thus, NAIFA

[29] On the other hand, fixed annuities are insurance contracts that provide guaranteed lifetime income and do not have a securities component. Thus, when selling fixed annuity products, advisors act as agents for insurance carriers and there are no broker-dealer relationships involved. *See* Annuity Compensation Models, attached hereto as Exhibit 2(b).

asks the Department to clarify in its final rule that any contract need only be signed by the investor, the advisor, and one financial institution (i.e., in the case of securities products, including variable annuities, the advisor's broker-dealer; in the case of fixed annuities, the insurance carrier).

c. Advisors should not have to provide warranties regarding financial institutions' incentive and compensation arrangements.

The proposed BIC exemption requires advisors to warrant that the financial institution (or any affiliate or related entity) does not use differential compensation or any other actions or incentives that would tend to encourage individual advisors not to act in the best interest of their clients. This warranty effectively undermines any compensation-related benefits an advisor could receive for complying with the BIC exemption. According to the Department, the BIC exemption is designed to allow financial professionals to continue receiving compensation that is ubiquitous in the marketplace (e.g., commissions, 12b-1 fees, revenue sharing, etc.). But this warranty requirement forces those professionals to effectively promise not to employ any of those common compensation arrangements in the first place.[30]

Moreover, this warranty is duplicative. Under the contract requirement, advisors must affirmatively state that they are acting as fiduciaries and in the best interest of the client. The best interest standard is in place to address the very problem presumably targeted by this warranty. Thus, NAIFA urges the Department to remove this warranty requirement from the final rule.

To the extent some version of this warranty remains in the final rule, NAIFA notes that registered representatives generally do not have the information necessary to make such a blanket warranty about the compensation and incentive practices of the financial institution for which they are an independent agent or registered representative. Therefore, NAIFA asks the Department to make clear in its final rule that any such warranty must be made by the financial institution, not the advisor.

d. Advisors should be permitted to limit the scope and duration of the fiduciary relationship.

BIC exemption contracts may not include "provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms."[31] Department officials stated at the May 7, 2015 technical briefing that they do not intend for this provision to bar advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the scope of services the advisor is willing to provide to a given client or the time period

[30] The Department's examples in the preamble of acceptable compensation arrangements (i.e., arrangements that would not violate this warranty) indicate that the Department is forcing everyone to flat-fee and wrap account arrangements. For the reasons discussed in the introduction to this comment letter, those arrangements will not benefit NAIFA members' clients.

[31] Proposed BIC Exemption, Section II(f)(1).

during which such services will be provided). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) that limits the duration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail ongoing advice (i.e., a one-time sales relationship), the advisor should be able to make clear that the fiduciary relationship encompasses only the sale, and the advisor does not have perpetual fiduciary obligations to the client. Further, advisors should be able to clarify the scope of (or disclaim) any ongoing monitoring obligations. NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a notice to the client.

2. *Advisors' disclosure obligations should be reduced.*

The proposed BIC exemption requires an advisor, prior to the purchase of any asset, to furnish the investor with a chart that provides, for each asset recommended, the "total cost" to the investor of investing in the asset for 1-, 5- and 10-year periods expressed as a dollar amount (using reasonable assumptions about investment performance). "Total cost" includes loads, commissions, opening fees, sub-transfer agent fees, etc. NAIFA interprets this provision to require growth projections for recommended products, which conflicts with current securities regulations.[32] At the May 7, 2015 technical briefing Department officials acknowledged this conflict and represented that they would resolve the issue in the final rule.

Aside from the conflict with securities laws, NAIFA has several general concerns about this type of disclosure requirement (i.e., projecting costs into the future). First, any cost projections—especially when put in a dollar amount—will be inherently unreliable because an advisor simply cannot predict what will happen with the market or with a given asset. Second, advisors' compensation, which is largely controlled by upstream financial institutions, can change at any given time, especially when compensation is based on an advisor's total book of business. Thus, any cost disclosure should be expressed in general terms (e.g., gross dealer concessions), not an actual dollar amount, and should not isolate advisor compensation from other entities' compensation (e.g., break out the broker-dealer and advisor portions of a shared commission). Third, a disclosure requirement of this nature would be very costly and burdensome for small, independent advisors. And fourth, as discussed in greater detail below, investors may not actually benefit from extensive disclosures of this nature.

In addition to the transaction-level total cost disclosure, the proposed BIC exemption includes obligatory annual disclosures, which are to be provided by the advisor or the financial institution for which the advisor is an agent or registered representative. We believe this annual requirement is duplicative and overly burdensome in light of the proposal's transactional disclosures and should be removed from the final rule. If the requirement is retained, however, NAIFA strongly encourages the Department to clarify that this particular obligation falls on the financial institution, and not the individual advisor. Advisors will not have access to the information subject to this disclosure requirement (e.g., total dollar amount of *all* fees paid by the

[32] *See* FINRA Rule 2210(d)(1)(f) (prohibiting performance predictions and projections).

investor, directly or indirectly, and *all* compensation received by the advisor and financial institution, which includes compensation paid to parties upstream from the advisor—fees about which the advisor would not be aware). And again, the burden of the disclosure requirement will be particularly heavy for independent advisors without back office support.

Regardless of which entity ultimately is responsible for making these disclosures, under the Department's proposal, investors will be inundated with complex charts and figures and duplicative information. This could result in heightened consumer confusion and no real consumer benefit. According to a LIMRA Secure Retirement Institute Survey published in May 2015, disclosures do not necessarily help investors grasp how much they are paying in fees or for what they are paying.[33] The survey asked participants in 401(k) plans about their perceptions about fees before and after disclosures were made and concluded that participants' understanding did not improve with disclosure, and half of those surveyed could not say how much they pay in fees following disclosure.[34]

Advisors and financial institutions already make product-specific disclosures to their clients under securities regulations and existing Department regulations like those under section 408b-2 (which, apparently, have limited usefulness). Increasing the cost and burden on advisors by adding unnecessary, confusing disclosures will not help retail investors. Accordingly, NAIFA recommends that the Department significantly narrow the disclosure requirements under the BIC exemption and, to the greatest extent possible, integrate any such requirements with existing client notices and disclosures.

D. Limited Product Offerings

NAIFA supports the Department's allowance under the BIC exemption for financial institutions and advisors to offer a limited range of investment options (e.g., proprietary products). The Department should clarify, however, that advisors who are not licensed to deal in securities products can offer, as a general rule, a broad enough variety of products to satisfy the best interest standard (i.e., just through the offering of non-securities insurance and annuity products). Department officials said at a meeting on May 20, 2015 that their intention was not to exclude entire groups of advisors with the best interest standard, and indicated that advisors without securities licenses would be able to satisfy the BIC exemption's requirements.

E. Special Exemption for Insurance and Annuity Products

NAIFA also supports the Department's proposed special exemption for insurance and annuity products, which allows advisors to recommend insurance and annuity products from insurance companies that are parties in interest. This special exemption is necessary for NAIFA members who are affiliated with, or captives of, insurance companies. It is NAIFA's understanding that the special exemption's relief is limited to certain party-in-interest (or in the case of IRAs, disqualified person) prohibited transaction rules, and does not extend to prohibited transaction

[33] LIMRA Survey, at 17.

[34] *Id.*

rules regarding conflicted compensation received by the advisor.[35] Thus, we interpret the proposal to require an advisor who receives compensation prohibited under ERISA or the Code to rely on the larger BIC exemption or PTE 84-24, depending upon the investor and transaction in question, to receive such compensation. NAIFA encourages the Department to elucidate the interaction between the special exemption and the broader PTEs in the final rule.

III. PROHIBITED TRANSACTION EXEMPTION 84-24

A. PTE 84-24 should apply to all annuity products sold to all types of investors.

The Department's proposed PTE 84-24 creates a convoluted compliance structure under which annuities transaction are divided between securities and non-securities products, and by the type of investor involved in the transaction (i.e., IRAs and plans). Under the proposal, PTE 84-24 will no longer be available for variable annuity or mutual fund sales to IRAs; to sell those products to IRA owners, advisors will have to rely on the more onerous BIC exemption. However, if those same products are sold to plans, PTE 84-24 still applies. For the following reasons, the Department should adopt a more balanced approach and retain 84-24 relief for all insurance and annuity products sold to all types of investors.

First, this structure is unnecessarily complicated and confusing. The proposed PTE 84-24, like the BIC exemption, requires advisors and financial institutions to adhere to impartial conduct standards, including the best interest standard, and to fulfill robust disclosure requirements.[36] It is not clear why the Department feels that some products for some investors should be split off and handled under a separate compliance scheme.

Second, as noted above, NAIFA members are compensated similarly for fixed and variable annuity products (i.e., through an upfront commission). To the extent the Department is concerned about different conflicts of interest arising from different compensation models, that concern is misplaced.

Third, the more complicated the compliance regime, the more costly it will be for advisors, financial institutions, and ultimately, consumers.[37] In this case, the Department's proposed

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[35] The "covered transactions" provision under the special exemption provides relief from specified ERISA § 406(a) rules and from Code § 4975(c)(1)(A) and (D), but does not include 406(b)-type relief.

[36] To the extent 84-24's conditions match the BIC exemption's conditions, NAIFA incorporates the same comments and suggestions made earlier in this comment letter.

[37] It is worth noting that annuity products are already subject to multiple layers of regulation. Because they are insurance products, they are heavily regulated at the state level. States have product content and marketing rules in place, as well as sales practices requirements. Additionally, the NAIC has model regulations (adopted by almost all of the states) on disclosures and suitability in annuity transactions. And of course, at the federal level, the SEC and FINRA regulate the sale of variable annuities. The Department should not add on top of this structure another complex, confusing and costly layer of regulation.

structure places a heavier burden on advisors who serve IRA owners, and particularly, on advisors who sell variable annuity products to those investors. As previously discussed in this letter, annuity products are generally sold to low- and middle-income investors who rely on the income stream from those products, and variable annuities are especially attractive to investors who desire those products' upside potential. Once again, the Department is actually disadvantaging middle market consumers by forcing their advisors to adhere to more onerous and costly requirements under the BIC exemption.

B. PTE 84-24 should cover the purchase by SIMPLE and SEP IRAs of variable annuities and mutual funds.

The Department proposes to revoke PTE 84-24 for the purchase by Individual Retirement Accounts of annuity products that are securities and mutual fund shares. "Individual Retirement Account" is defined broadly to include "individual retirement accounts" and "individual retirement annuities" described in 26 U.S.C. §§ 408(a) and (b), respectively. Subsections 408(k) and (p) then define SEP and SIMPLE IRAs as employer-sponsored "individual retirement accounts" or "individual retirement annuities" (as described in subsections (a) and (b)) with specific participation, contribution and other requirements.[38]

The Department should not revoke PTE 84-24 for SIMPLE and SEP IRA purchases of variable annuities and mutual funds. These employer-sponsored IRAs are akin to traditional pension plans in that they are retirement savings vehicles established for the benefit of individual employees. Because they have fewer reporting requirements and are easier to administer, these types of plans are especially popular with small employers.

As drafted, the Department's proposal unfairly burdens advisors who sell SIMPLE and SEP IRAs to employers (i.e., small employers) instead of traditional 401(k) plans because they are forced to rely on the more onerous BIC exemption in order to place variable annuities and mutual funds in these plans.[39] This discrepancy between requirements for different types of employer-sponsored retirement savings plans is not warranted.

The investment advice services provided to employers who adopt SIMPLE and SEP IRAs are the same as the services provided to employers who adopt 401(k) plans (i.e., evaluation of the employer's particular needs, recommendations about plan types, and recommendations about investment options offered through the plan). To the extent NAIFA members advise employers on plan and menu design and receive some variable or third-party compensation for their services (i.e., do *not* use the common employer fee model described in detail at the beginning of this letter), they should be able to rely on PTE 84-24, regardless of the type of retirement plan in place.

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[38] Section 408(c) provides that "a trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries . . . shall be treated as an individual retirement account (described in subsection (a))" if the governing instrument creating the trust meets certain requirements.

[39] As a practical matter, fixed annuities are not sold to employer-sponsored retirement plans of any type.

Like recommendations made to employers with 401(k) plans, investment advice given to employers with SIMPLE and SEP IRAs is a step removed from recommendations pertaining to the employees' ultimate investment decisions. With the help of an advisor, the employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising between the advisor and a plan of any type is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved.

Accordingly, advice to employers regarding plan and menu design should be covered under PTE 84-24 and not the more onerous BIC exemption, regardless of whether the advisor is selling group annuity or mutual fund products and regardless of whether the employer chooses to offer a traditional 401(k) plan or a SIMPLE or SEP IRA to its employees.

C. PTE 84-24's compensation relief should be expanded.

1. *PTE 84-24's compensation relief should be coextensive with the BIC exemption's relief.*

For transactions that are covered under the proposed 84-24, the Department has limited compensation relief to agents, brokers and principal underwriters to narrowly-defined "Insurance Commissions" and "Mutual Fund Commissions." Unlike current PTE 84-24, the proposal explicitly excludes revenue sharing, administrative fees, marketing payments, and payments from parties other than the insurance company or its affiliates. The Department's justification for such restrictions on compensation relief under 84-24 (and not imposing such restrictions under the BIC exemption) is unclear.

Proposed 84-24 imposes the same "best interest" standard as that under the BIC exemption, as well as other impartial conduct standards and disclosure requirements. The mandate that advisors act in the best interest of their clients should assuage concerns the Department may have about particular compensation arrangements. Thus, the Department should extend 84-24's compensation relief to be coextensive with the BIC exemption's relief.[40]

2. *PTE 84-24's compensation relief should at least be extended to include mutual fund commissions for agents.*

If the Department opts to not extend 84-24's relief to match the BIC exemption's relief, the Department should—at the very least—extend 84-24's coverage to include Mutual Fund Commissions paid to Principal Underwriters *and their agents.* As drafted, the proposed PTE 84-24 allows for payment of insurance commissions to insurance agents and brokers, but does not allow agents or registered reps to receive commissions for mutual fund sales, even though the

[40] It is our understanding that the special exemption for insurance and annuity products contained under the BIC exemption provides relief from ERISA and Code party in interest/disqualified person rules, whether the transaction falls under the BIC or 84-24 for conflicted compensation relief. Again, we request that the Department clarify this point in its final rule.

same impartial conduct standards and exemption conditions apply equally to the sale of insurance and annuity products, and mutual funds. Without any apparent justification, the Department's proposal allows agents to be paid for one product line, but cuts off their compensation for another.[41] The Department should remedy this discrepancy by allowing agents to be compensated for mutual fund sales.

IV. THE DEPARTMENT SHOULD EXTEND THE ENFORCEMENT TIMELINE TO AT LEAST THIRTY-SIX MONTHS

The proposed eight-month enforcement timeline for compliance with the new rule is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

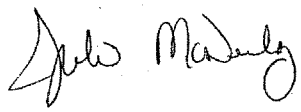
The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

Each one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

[41] Agents and brokers are paid almost exclusively on a commission basis for the sale of mutual fund shares.

Very truly yours,

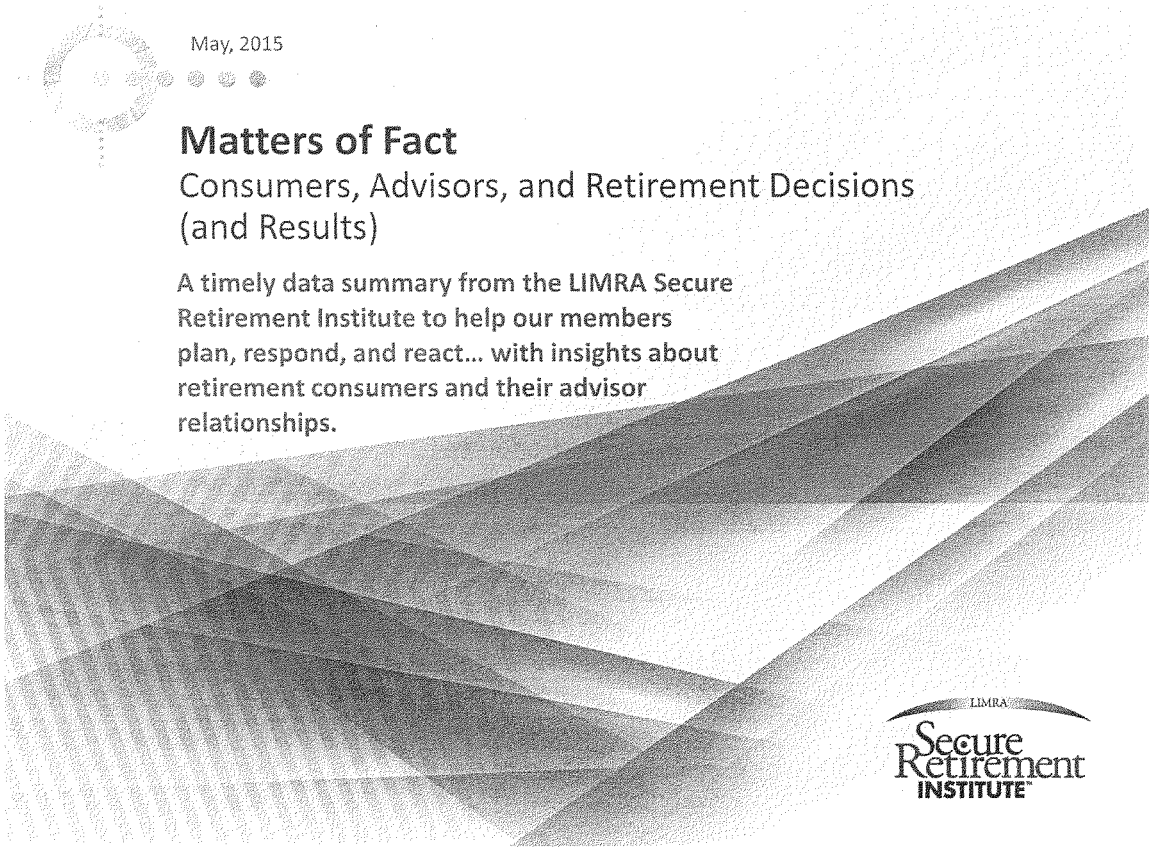


Juli Y. McNeely, LUTCF, CFP, CLU
NAIFA President 2014-2015

Exhibits: NAIFA Comment Letter on Proposed Rule
Diagrams of Compensation Models
LIMRA Secure Retirement Institute 2015 Consumer Survey
Principal Funds Table on Asset Class Performance from 1994 to 2013

Exhibit 2

LIMRA Secure Retirement Institute 2015
Consumer Survey


May, 2015
Matters of Fact
Consumers, Advisors, and Retirement Decisions (and Results)
A timely data summary from the LIMRA Secure Retirement Institute to help our members plan, respond, and react… with insights about retirement consumers and their advisor relationships.
LIMRA
Secure Retirement INSTITUTE

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NOTE: Throughout this report, the term "Advisor" refers to a paid financial professional (e.g. broker, financial planner or advisor) used to make at least some of household investment decisions.

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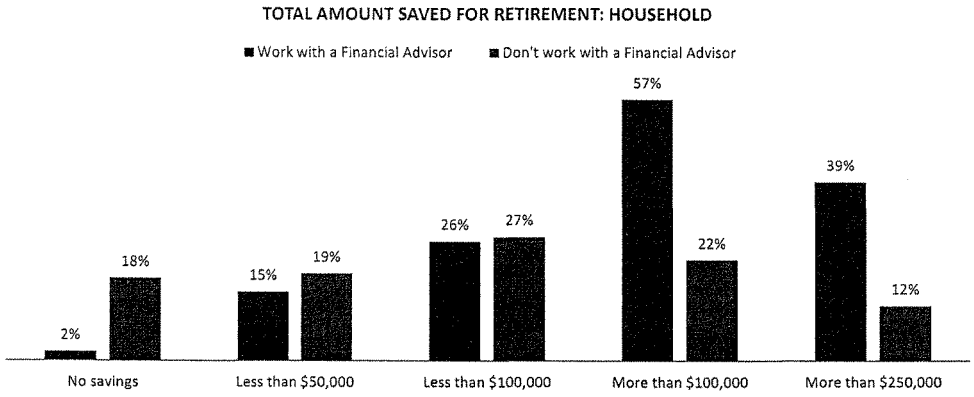
Advisors Are Linked to Better Results: Total Retirement Savings

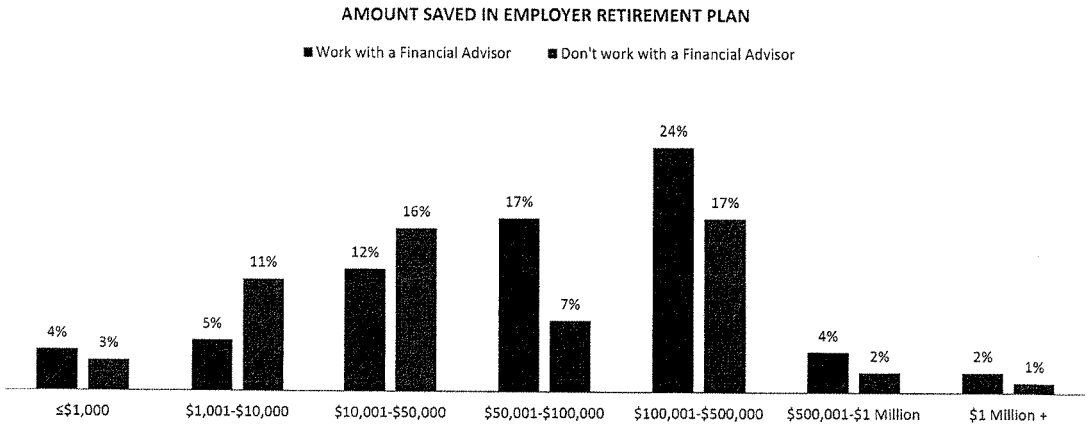
Households that use financial advisors are three times as likely as non-advised households to have $250,000 or more in retirement savings ... and are more than twice as likely to have $100,000 or more.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Advisors Are Linked to Better Results: In-Plan (DC)

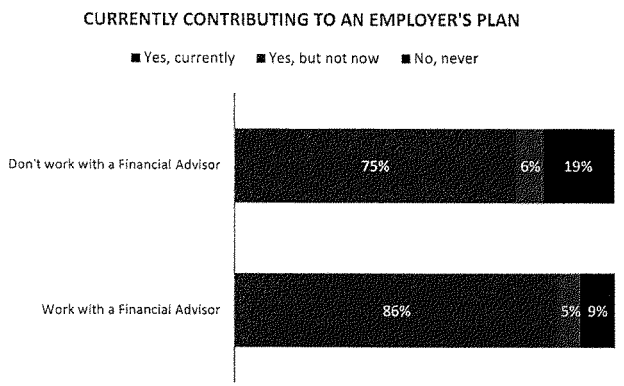
People who engage financial advisors have higher retirement account balances in employer retirement plans.

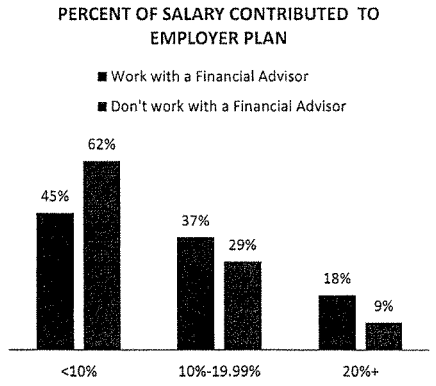


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

People With Professionals Are More Engaged in Employer Plans

People who work with financial advisors are more likely (than those who do not) to participate in their employers' DC plans. More of those with advisors also demonstrate "good" behavior — contribute 10 percent or more to their employers' plans (and are twice as likely to contribute 20 percent or more).

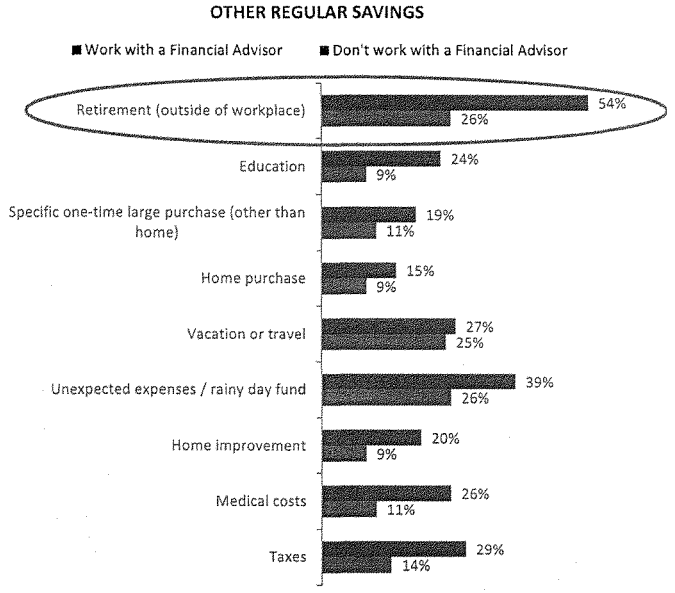




Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

People who Consult Professionals Save Regularly for a Variety of Goals

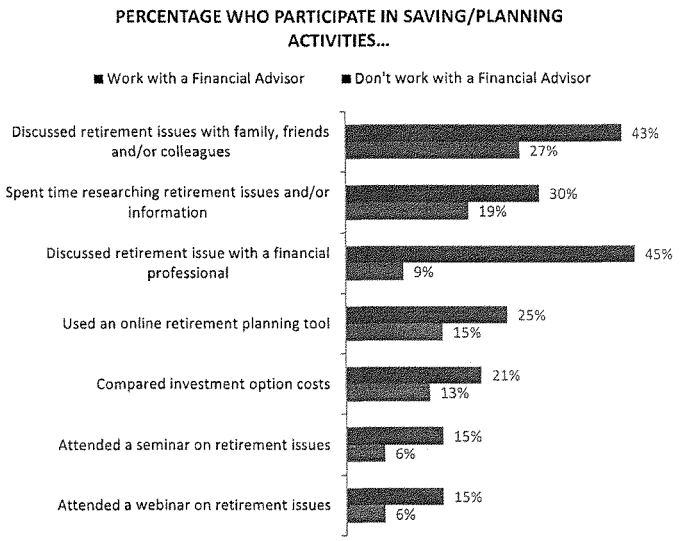
Advisors can also add value by encouraging clients to save holistically, not just for retirement. For nearly every listed savings goal (except vacation), advisors' clients are significantly more likely to save on a regular basis compared with people who don't consult advisors.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Advisors are Associated with Engagement and Activity

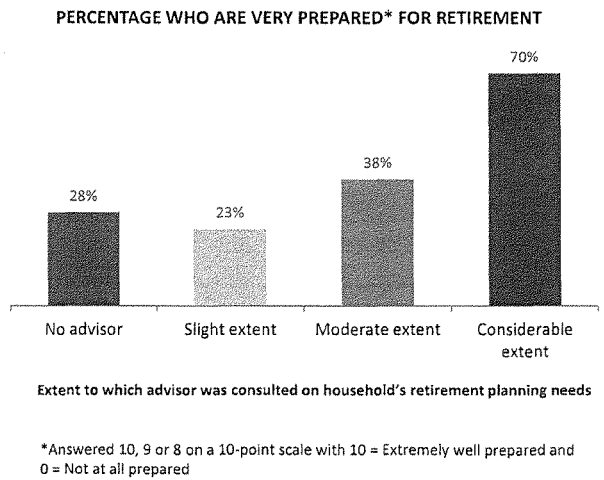
Advisors can help their clients engage with their own retirement and financial lives. People who use advisors are more likely to discuss their retirements with a range of individuals, from family to financial professionals; and, to conduct basic planning activities such as attending seminars and webinars, and using planning tools.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Pre-Retirees' Preparedness Linked to Degree of Advisor Reliance

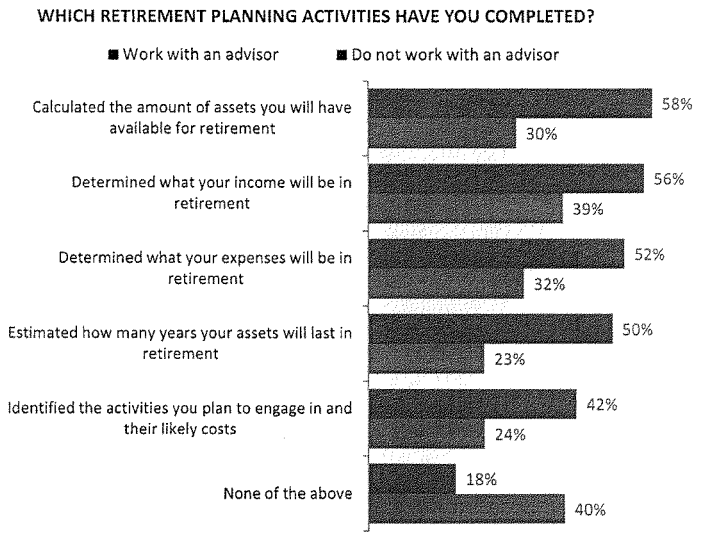
People who use an advisor – especially to a considerable extent – are significantly better prepared for retirement than those who don't consult an advisor, or who do so only slightly.



Source: *Advisor Perspectives on Retirement Planning*, LIMRA Secure Retirement Institute, 2012

Using an Advisor Tracks with Increased Engagement

Pre-retirees who work with financial professionals are more likely to complete key planning activities.

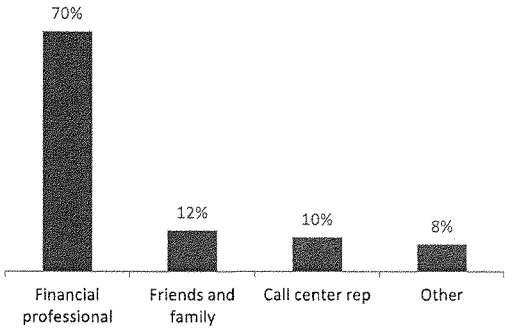


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

IRA and Rollover Decisions Are Not Purely a Function of Fees

Financial professionals/advisors are highly influential in helping individuals to make informed rollover decisions.

WHO HAD THE MOST INFLUENCE OVER THE ROLLOVER DECISION?*

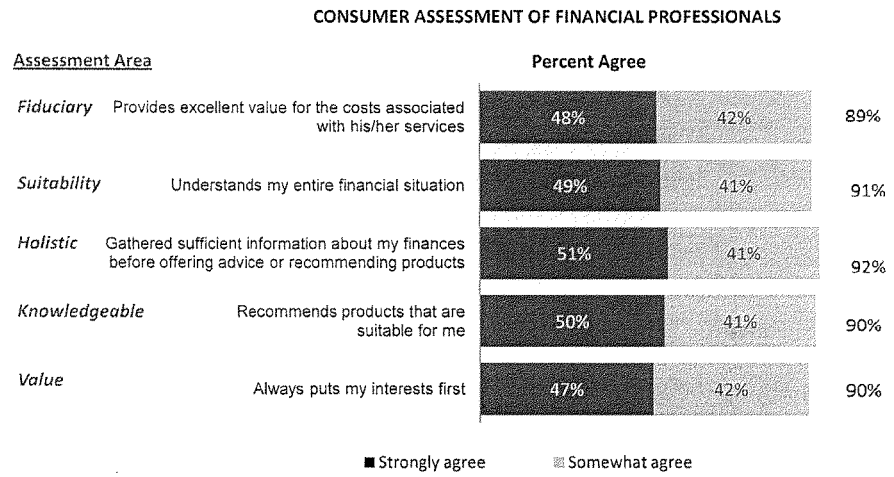


*When consumers near retirement or recently retired (aged 55 to 70) rolled money from a DC plan into an IRA and spoke with someone about their decision.

Source: LIMRA Secure Retirement Institute 2014 Rollover Consortium

People Value Their Advisors

Consumers feel that advisors look out for their best interests, and understand their own needs and goals.

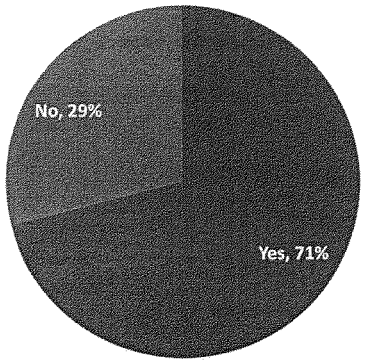


Source: *Quarterly Consumer Sentiment Q2 2015,* LIMRA Secure Retirement Institute.

Disclosure Does Not Improve Participant Knowledge About Fees

Even after disclosure, most participants think DC plan fees and expenses are reasonable... but few pay a great deal of attention to disclosure when delivered.

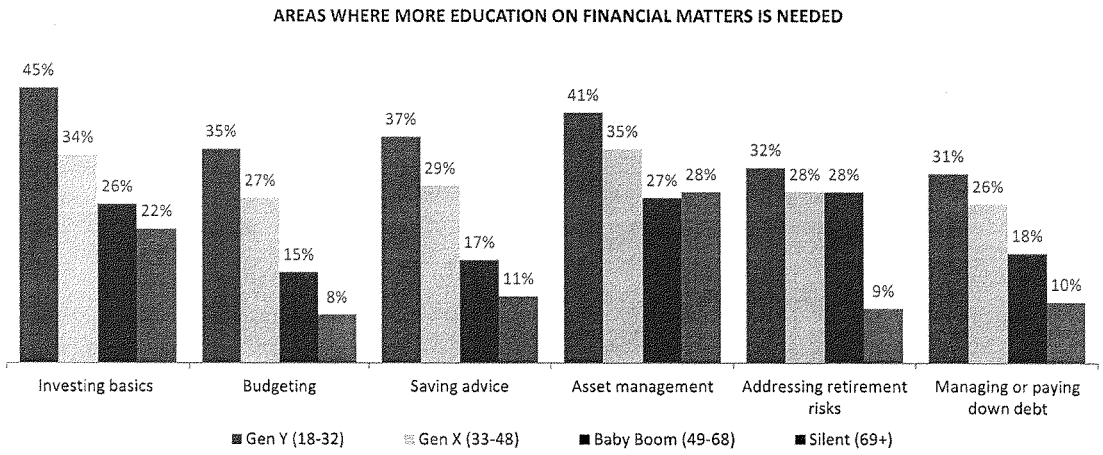
PERCENT WHO AGREE THAT DC PLAN FEES/EXPENSES ARE REASONABLE



Source: *Deciphering Disclosure,* 2013, LIMRA Secure Retirement Institute

Consumers Want More Education

Many consumers, especially younger ones, say that they need additional guidance on matters critical to financial security and retirement planning.



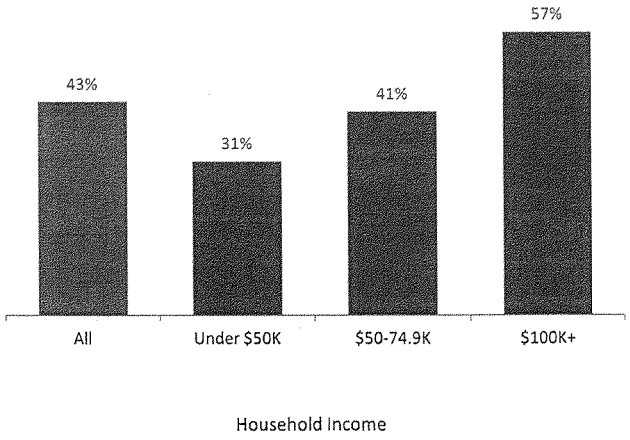
Source: *Third Quarter 2013 Consumer Perspectives,* LIMRA Secure Retirement Institute.

A Majority of Consumers Do Not Take an Active Role in Managing Their Assets

Only 4 in 10 consumers are actively engaged in managing their assets.

Even among high-net-worth consumers, only 6 in 10 actively manage their assets.

PERCENTAGE OF PEOPLE WHO ARE VERY INVOLVED WITH MONITORING AND MANAGING THEIR RETIREMENT SAVINGS.



Sources: *Financial Triage Assessing Consumer Wellness (2015)* and 2014 Consumer Survey, LIMRA Secure Retirement Institute

"Best Interests" Differ Based on Attitudes and Preferences

Consumers with similar demographic profiles, wealth levels, and lifestyle ambitions may have very different preferences and financial priorities. Because their attitudes toward money differ, we developed three consumer segments based on the income solutions they prefer.

Three money mind-sets:

- **Guarantee Seekers** – Want to know that their income won't disappear. Have a floor of lifetime guaranteed income and would be interested in converting even more of their savings to a pension-like contractual guarantee. Want to spend money without the day-to-day worry of how long it has to last. Want the peace of mind of a certain outcome.
- **Estate Planners** – Financially savvy. Understand that equity markets generally out-perform risk-free fixed investments. Can withstand a little volatility to maximize the potential of investments. Trust their own investment decisions. Want to maintain personal control over investment decisions and to retain the flexibility to adjust income and spending as needs change over time.
- **Asset Protectors** – Have been saving money for a long time. Do not want to see savings account balance decrease. Will live off the interest and dividends of savings, but are uncomfortable invading principal. Don't want to be "poorer."

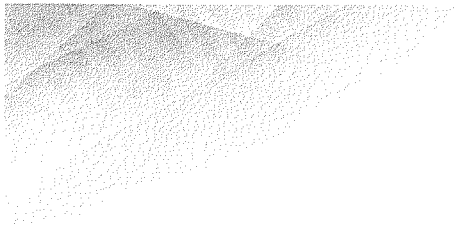
Source: *A New Perspective on Retirement Income*, 2015, LIMRA Secure Retirement Institute

Additional Facts and Research Data

- Controlling for household wealth, individuals who work with paid financial professionals are more likely to have formal, written retirement plans and to be confident that they are on track with their retirement savings.
- Confidence in being able to live their desired lifestyle in retirement is higher among those working with paid financial professionals, particularly for less-wealthy households.
- Among pre-retiree households with less than $500,000 in financial assets, there is a significant difference in subjective levels of retirement preparedness between those who work with financial professionals and those who do not work with financial professionals.
- Individuals who work with paid financial professionals are twice as likely as those not working with paid financial professionals to say that they had a discussion reviewing the pros and cons of doing a rollover to an IRA versus leaving the money in the plan.
- For pre-retirees (aged 55 to 70), the most common reasons involve consolidation of assets, gaining greater control over their money, seeking better returns, not wanting to leave their money with their former employer, and access to a greater range of investments.
- Pre-retirees say their desire for consolidation, better returns, and control most influenced their rollover decisions. Fees were not a significant factor.
- Seeking lower fees is not a major motivator, regardless of who had the greatest influence.
- Despite regulatory concern over conflicts of interest, 9 in 10 consumers agree that their financial professional always puts their interests first.
- Nine in ten agree that their financial professionals provide excellent value for the costs associated with their services. This assessment does not vary based on compensation method.
- Half of consumers who work with a financial professional have worked with their advisor for more than five years.
- Two thirds of consumers had a financial professional help with their rollover decision. Seven in ten consumers say the discussion they had with the financial professional about the advantages and disadvantages of the options they could take with their retirement plan assets was helpful.

Additional Facts and Research Data (Continued)

- DC participants don't spend a lot of time reading their statements. Most people spend less than 10 minutes with their statements.
- The Institute asked participants about their perceptions of 401(k) fees before and after disclosure. People don't have a good grasp of what they were paying, before or after. Despite receiving a fee disclosure notice, half of DC participants can not say how much they pay in fees.
- DC participants are generally satisfied with the value for cost.
- Only one third of consumers have a long-term financial plan. One in three have a monthly household budget.
- Slightly more than half of consumers have neither. Only 19 percent of consumers have both a short-term budget and long-term financial plan.



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July 21, 2015

VIA ELECTRONIC FILING – www.regulations.gov

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., NW
Suite 400
Washington, DC 20210

RE: RIN 1210-ZA25 - Proposed Prohibited Transaction Exemptions D-11712 (Best Interest Contract Exemption) and D-11850 (PTE 84-24)

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department" or "DOL") proposed prohibited transaction exemptions ("PTEs") under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[1]

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

BACKGROUND & EXECUTIVE SUMMARY

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[2] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

[1] NAIFA has filed a separate comment letter on the Department's proposed definition of fiduciary "investment advice," which is attached hereto as Exhibit 1.

[2] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in further detail below, some of our members' existing compensation arrangements do not violate ERISA or Code prohibited transaction rules, and therefore do not require compliance with a PTE.[3] To the extent NAIFA members must rely on PTEs, however, we have serious concerns about compliance burdens under the Department's proposal, particularly with respect to the Best Interest Contract ("BIC") Exemption and the proposed revisions to PTE 84-24.

Despite Secretary Perez's statement before Congress on June 17, 2015 that the Department's proposal makes things "simpler" by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed PTEs are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

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[3] Diagrams of common compensation arrangements for advising employers on plan design (employer plan model) and for the sale of fixed and variable annuities (annuity models) are attached hereto as Exhibits 2(a) and 2(b), respectively.

Accordingly, NAIFA recommends that the following revisions be made to the proposed BIC exemption and PTE 84-24:

Best Interest Contract Exemption -

- Simplify and clarify the exemption's requirement to the greatest extent possible in order to avoid litigating areas of uncertainty;
- Align the exemption's conditions as closely as possible with existing SEC requirements to avoid a dual regulatory system for securities products;
- Hone the "best interest" definition to account for varying perspectives and opinions on particular investment products and business practices; specifically:
  - Refine the "prudent person" term by, for example, expanding the clause to reference a "prudent person serving clients with similar retirement needs and offering a similar array of products;"
  - Provide a clear and explicit statement that offering products on which there are varying opinions within the industry (e.g., variable annuities) does not violate the best interest standard; and
  - Provide a clear and explicit statement that offering proprietary products (even a limited suite of such products) does not violate the best interest standard;
- Clarify that the exemption covers rollovers and distributions (to the extent those activities are considered fiduciary investment advice);
- Modify the contract conditions, specifically:
  - Eliminate the formal contract requirement and replace it with a non-signatory point-of-sale notice that binds advisors and financial institutions to act in the best interest of their clients;
  - Or, if the Department retains the contract requirement, clarify:
    - that any contract need not be signed prior to the point of sale;
    - that the contract need not be signed by more than one financial institution;
    - that advisors do not have to provide warranties regarding another entity's (e.g., a financial institution) incentive and compensation arrangements;
    - that the contract may contain language reasonably limiting the scope and duration of the fiduciary relationship;
- Lessen advisors' disclosure obligations, particularly to the extent they conflict with securities laws or involve information that is not readily accessible to individual advisors;
- Clarify that non-securities licensed advisors can satisfy the best interest standard; and
- Explain and clarify the interplay between the special exemption for insurance and annuity products, the larger BIC exemption, and other available PTE relief.

Proposed PTE 84-24 –

- Expand the scope of the PTE to cover all annuity products sold to all types of investors;
- Do not revoke the PTE for SIMPLE and SEP IRA purchases of variable annuities and mutual funds; and

- Expand the PTE's compensation relief to be coextensive with the BIC exemption, or at the very least, to allow agent commissions for mutual fund sales.[4]

Below is a detailed discussion of the foreseeable impact of the Department's proposal, as drafted, and the aforementioned recommendations to make the proposal less onerous.

I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[5] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[6] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[7] Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[8]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by

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[4] To the extent PTE 84-24's proposed conditions are the same as those under the BIC exemption, NAIFA's comments with respect to those conditions apply to both exemptions.

[5] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[6] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[7] *Id.*

[8] *Id.*

making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[9] And small businesses that work with a financial advisor are 50%

[9] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[10] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[11] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[12]

B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
>
> (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
>
> (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a

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[10] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 3.

[11] Oliver Wyman Study, at 6.

[12] LIMRA Survey, at 13.

given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[13] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[14] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

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[13] Oliver Wyman Study, at 6.

[14] *Id.*, at 7.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[15] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for

[15] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

II. THE DEPARTMENT SHOULD CLARIFY THAT SOME FEE ARRANGEMENTS DO NOT REQUIRE COMPLIANCE WITH A PROHIBITED TRANSACTION EXEMPTION

A. Non-Variable, Negotiated Fees Paid by the Client should not Trigger PTE Compliance Requirements

ERISA and Code prohibited transaction rules generally bar fiduciaries from receiving compensation that varies based on the investment advice given or the investment choice made by the investor, as well as compensation from third parties. Flat fee arrangements and other non-variable compensation (e.g., wrap accounts), however, are permitted.[16] Thus, some of our members' existing compensation models should not violate the prohibited transaction rules or trigger any obligation to comply with a PTE.[17]

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[16] *See* ERISA §§ 406 and 408b-2(e); DOL Frost Advisory Opinion (97-15A) (May 22, 1997); DOL Field Assistance Bulletin 2007-1 (Feb. 2, 2007).

[17] NAIFA explains in its comment letter on the Department's proposed rule that advice to employers on plan and menu design (irrespective of plan type) should be excluded entirely from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising at this stage between the advisor and the employee investors is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved. The arguments in this letter are presented as alternatives, in the event the Department decides not to grant a carve-out for these services from the definition of fiduciary investment advice.

For instance, many NAIFA members advise employers, under a negotiated fee arrangement[18], on how to set up employee retirement plans. Our members' services include analysis of the employer's specific needs, recommendations related to general plan models (e.g., 401(k), SIMPLE IRA, etc.), and advice about the investment options that are offered through the plan (e.g., particular mutual funds or annuity products). These services generally are provided on a fee basis.

The advisor's fee is negotiated in advance with the client (the employer), and is usually expressed as a percentage of assets held in the plan (i.e., basis points).[19] The fee amount is invoiced through the advisor's broker-dealer (or, in the case of a group annuity product, through the insurance carrier).[20] Once the fee is remitted, the financial institution forwards the advisor's compensation to her. Notably, the advisor's fee amount *does not vary* based on the plan type or investment options selected by the employer. Although the fee is invoiced through the financial institution, the advisor's compensation comes from the employer. The advisor does not receive any other compensation (e.g., trailers, revenue sharing, etc.) from the employer or any third parties for these services.

Some advisors employ this same fee model to advise individual employees on their investment choices within the plan. In such instances, the employer's fee package covers this service for the employees. Again, the advisor's compensation does not vary based on the investment options selected by the employee, and the advisor does not receive any additional compensation from any source for these services.

Similarly, NAIFA members help employers set up SIMPLE and SEP IRAs for their employees. These plans are especially appealing to small employers because they are far less burdensome to administer than traditional 401(k) pension plans. Our advisors provide the same services to employers who choose to offer SIMPLE and SEP IRAs as those described above with respect to setting up a 401(k) plan (i.e., discussing and evaluating plan design options, and narrowing down the options to be offered through the plan). And the same fee structure generally applies, regardless of whether the employer chooses to offer a 401(k) plan or a SIMPLE or SEP IRA (i.e., non-variable fee based on percentage of assets in the plan, negotiated with the employer, invoiced through the financial institution).[21]

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[18] This fee arrangement—the employer plan model—is diagramed in Exhibit 2a.

[19] Notably, our Members are often in a competitive bidding process with other advisors for these employers' business. Thus, our advisors are incentivized to keep costs as low as possible for the employer.

[20] We note that this invoicing step (i.e., billing through a broker-dealer or carrier) creates some confusion in terminology under state law. Some states label any compensation that is billed through a third party a commission, not a fee. However, this pure invoicing function should not create concern for the Department under the ERISA and Code prohibited transaction rules.

[21] SIMPLE and SEP IRAs can differ from plans when it comes to compensation for advising individual employee participants. In some cases, compensation for employee-level advice under a SIMPLE or SEP IRA is done on a commission basis (similar to traditional compensation

Fees paid by employers for plan design services (for all plan types) are negotiated between the advisor and the client and are either a set dollar amount or a percentage of total assets under management. Although the fees are invoiced through a financial institution, they are paid by the client, not a third party. The fees do not vary based on the plan type or investment options selected by the employer. In some cases, the employer's fee also covers advice to individual employees regarding their investment options under the plan. The Department should clarify that this type of fee arrangement for fiduciary investment advice—whether the advice is given to the employer or the individual employees—is permitted under the current rules and does not require compliance with a PTE.

B. Upstream Conflicted Compensation should not Trigger PTE Compliance Requirements for Advisors

In general, NAIFA encourages the Department to divorce conflict-of-interest concerns at the advisor level from those at the broker-dealer or carrier level. Our members often are not aware of the compensation arrangements for carriers and broker-dealers. Furthermore, compensation at the broker-dealer or carrier level, in many circumstances, has no impact at all on an advisor's investment advice or the advisor's compensation for that advice.

For example, in the plan design scenario described above, our members receive a flat, negotiated fee for services, and their compensation does not vary based on how the client reacts to the investment advice given. Thus, regardless of upstream compensation arrangements, there is no conflict at the advisor level. The Department should clarify that so long as the advisor's own compensation does not violate the prohibited transaction rules, the advisor does not need to comply with an exemption.

III. BEST INTEREST CONTRACT EXEMPTION ("BIC")

Secretary Perez and Department officials have stated on several occasions that the objective of the proposed PTEs—particularly the BIC exemption—is to create an enforceable "best interest" fiduciary standard.[22] The Department has professed flexibility, however, regarding how such a standard is operationalized. NAIFA does not oppose the Department's overall goal; in fact, our members believe that they already satisfy a best interest standard.

NAIFA has significant concerns though about the onerous, costly nature of the proposed BIC exemption (upon which the vast majority of our members will have to rely, due to the clients we serve). Despite the Department's repeated characterization of the proposed exemption as "principles-based" and flexible, the proposal is in fact highly prescriptive. Its effect, as drafted,

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arrangements for mutual fund sales) and is not directly negotiated with or paid by the employer. We recognize that for advisors to continue to receive this compensation for employee-level advice, they will have to comply with a PTE.

[22] *See, e.g.,* Comments of Secretary Perez, hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

will be to drive all advisors and financial institutions to a uniform business model with flat-fee compensation arrangements and unnecessarily formalized and burdensome advisor-client interactions, none of which suits small account holders or unsophisticated investors. For all of the reasons discussed previously in this comment letter, advisory fee-based compensation models are not appropriate or desirable for small account holders, and the dramatic increase in the cost of doing business under the proposed PTEs will substantially increase costs for clients under traditional brokerage-account compensation arrangements.

Furthermore, the BIC exemption's contract requirement portends a substantial increase in litigation and penalty exposure for advisors, especially those advising IRA owners. To the extent *any* of the exemption's requirements are unclear under the final rules, litigation will likely ensue. For instance, the "best interest" standard, as proposed, is open to different interpretations even among industry professionals (discussed more fully below), and is therefore ripe for consumer lawsuits. In addition to the increased threat of litigation, advisors will also face substantial risk of excise tax penalties under the Code as they navigate and implement a brand new compliance regime.[23] A high level of litigation and penalty exposure will increase the cost of doing business for advisors and financial institutions, and in some cases, the amplified risk will cause services to disappear for middle market clients. Thus, NAIFA strongly prefers that the Department finalize a clear, simple BIC exemption, rather than rely on the courts to define the contours of the rule through costly litigation over the span of several years.

Compounding the difficulty with the BIC exemption is the fact that, for securities products, it sets up a dual regulatory regime with the SEC. In every instance where the exemption differs from the SEC's requirements—in the timing and content of disclosures or a brand new contract requirement, for example[24]—advisors and financial institutions will be faced with an extra layer of compliance burden. Therefore, it is important for the Department to finalize the exemption's conditions in such a way that they correspond with or can be incorporated into existing regulatory requirements. Cohesion between regulatory systems will significantly mitigate cost increases and decrease confusion for advisors and consumers.

In general, eliminating or minimizing complexity and uncertainty under the BIC exemption (to the greatest extent possible) will help advisors and investors in the long run by establishing comprehensible obligations and expectations, by limiting litigation risk and expense, and by avoiding excessive regulatory burdens. NAIFA recommends that the Department simplify the BIC exemption's requirements and offers the following specific recommendations for streamlining the proposal.

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[23] The Code currently gives advisors a 14-day correction period in which to correct a transaction that violates certain Code prohibited transaction rules and avoid an excise tax penalty. 26 U.S.C. §§ 4975(d)(23) and (e)(11)(A). Given the complexity of the Department's proposal and the substantial differences between it and the current rules, NAIFA encourages the Department to consider implementing an extended correction period so that advisors have sufficient opportunity to identify and fix any inadvertent errors during this transition period.

[24] *See, e.g.,* SEC disclosure requirements for clients and prospective clients, 17 CFR 275.204-3 (Delivery of Brochures and Brochure Supplements); *see also* Part 2 of Form ADV.

A. The "Best Interest" Standard Should Be Refined to Take into Account Varying Perspectives and Opinions on Investment Products and Business Practices

We all agree that advisors should act in the best interest of their clients. It is important, however, that the concept of "best interest" not be conflated with "best performance." It is equally important not to confuse "best interest" with "least expensive."

A Principal Funds chart attached hereto as Exhibit 4 shows the volatility in asset class performance between 1994 and 2013. The best- and worst-performing assets change constantly. Because no one can predict the future, diversification is essential to any investment strategy. Further, not all investment products are created equal—the quality and level of risk of different products can vary dramatically. And of course, clients' needs differ and fluctuate widely. Thus, in many instances, an appropriately diversified, high-quality, individually-tailored investment portfolio will not include the least costly products; and yet, given the multitude of factors to consider, such a portfolio is in the client's best interest. To the extent the Department's best interest standard takes into account individualized needs and considerations, and does not turn on performance or cost, it has NAIFA's full support.

One element of the Department's proposed best interest standard does concern us, however. Under the Department's proposal, advice is in the best interest of the investor when the advisor (and financial institution):

> acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the [investor], without regard to the financial or other interests of the [advisor or her affiliates].[25]

NAIFA encourages the Department to refine the meaning of "prudent person" within this definition.

The retirement planning industry includes diverse advisors who serve diverse clients and deal in a broad array of products. As a result, there always will be disagreement in the industry about the wisdom or desirability of certain approaches or certain products. For example, there is controversy within the industry about the utility and desirability of variable annuity products. There may also be disagreement among industry professionals about captive advisors offering clients a limited suite of proprietary products (i.e., an industry bias toward independent reps over captives).

Despite these differences in opinion, however, these products and approaches are valuable to investors. Indeed, investors *want* them or they would not be offered. Variable annuities, for instance, provide some investors with a much-needed income stream for life, and may be attractive for their upside potential and tax structure, and proprietary products provide consumers with well known, high-quality investment options (often through local Main Street advisors). Ultimately, consumers should be able to choose from a broad range of investment options (and a range of professional advisors) because there is no "one size fits all" in this context.

[25] Proposed BIC Exemption, Section VIII(d).

NAIFA recommends that the Department take three steps to account for intra-industry differences like these and to preserve consumer choice under the best interest standard:

> (1) refine the "prudent person" term by, for example, expanding the clause to reference a "prudent person serving clients with similar retirement needs and offering a similar array of products;" and
>
> (2) include a clear and explicit statement that offering products on which there are varying opinions within the industry (e.g., variable annuities) does not violate the best interest standard; and
>
> (3) include a clear and explicit statement that offering a limited suite of proprietary products does not violate the best interest standard.

Without such clarification, these issues will end up being litigated, generating substantial expense and confusion for advisors and investors alike. The likelihood of litigation on these points presents a direct threat to many of our members' businesses, given the large number of them who deal in annuities and proprietary products. Accordingly, it is vital that the Department hone its best interest standard to ensure it is workable across the industry and not employed to target or undermine specific products or business practices.

B. Scope of the Exemption Should Be Expanded to Cover Rollovers and Distributions

The BIC exemption currently is limited to "services provided in connection with a purchase, sale or holding" of a defined list of assets.[26] NAIFA interprets the current scope of the exemption to exclude advice and services related to rollovers, distributions,[27] and the opening of IRA accounts. Department officials stated at a technical briefing on May 7, 2015 that they do intend to cover rollovers and distributions under the BIC exemption. NAIFA encourages the Department to clarify this point by revising the provision on "covered transactions" under the BIC exemption or by broadening the definition of "asset" for purposes of the exemption.

C. Exemption Conditions

1. *The Department should not require a formal contract, but rather a non-signatory notice.*

The fundamental purpose of the BIC exemption's contract requirement, according to the Department, is to create a binding obligation—of which consumers are aware—for advisors to act in the best interest of their clients. NAIFA does not take issue with this goal. But NAIFA does encourage the Department to adopt a more tenable approach to achieving its objective.

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[26] Proposed BIC Exemption, Section I(b).

[27] NAIFA argues in its comment letter on the Department's proposed rule that distributions should not be treated as "investment advice." This argument is presented in the alternative, in the event the Department does not create such a carve-out.

Requiring a lengthy, complicated contract executed by at least three parties goes beyond what is necessary to create an enforceable obligation. It is our understanding that the Department has proposed such a requirement in order to obtain enforcement authority over IRA advisors who would otherwise only be subject to the Code's fiduciary regime. But it is unclear to us where, under ERISA or the Code, the Department has been granted authority to circumvent the statutory enforcement structure in such a way.

Instead of a formal contract, the Department should require a non-signatory notice at the point of sale, which would bind advisors and financial institutions to act in the best interest of their clients and be actionable if the standard of conduct were not met. A notice-type requirement would entail far fewer implementation challenges than a formal contract, could be effected more quickly, and would provide meaningful disclosure of the conduct standard to customers (without placing on them the burden of executing formal contracts).

To the extent the Department retains a formal contract requirement, however, NAIFA recommends the following changes in order to make any such obligation workable.

a. Any contract or notice requirement should be triggered at the point of sale and not before.

Secretary Perez and Department officials have said on multiple occasions that they do not intend to require a signed contract before preliminary conversations between an advisor and an investor. The text of the proposed exemption, however, indicates something different; specifically, it requires that a contract be in place *prior to any recommendation* by the advisor that an investor purchase, sell, or hold an asset.[28] In other words, a contract must be in place before an advisor provides a recommendation or an investor decides to rely on that recommendation in any way (or, just as likely, declines to act on it at all).

Any contract or notice requirement should be triggered by an investment *action* taken on the client's behalf (i.e., some affirmative reliance by the investor on the advice). NAIFA encourages the Department to revise its approach such that any contract requirement is tied to an actual transaction (e.g., at the point of sale or as soon as practicable after an executed transaction). A contract requirement at the conversation stage of the investor-client interaction is premature and unnecessary (because there may not even be any action taken in the best interest of the client or not in the best interest of the client), and will only stifle preliminary conversations about investors' options.

Requiring a contract prior to the point of sale presents particular problems for independent advisors selling annuity products (fixed or variable). Some of our advisors sell annuity products from dozens of insurance carriers. If a contract requirement is triggered by a simple recommendation (or, given the Department's restrictive education exception under the definition of "investment advice," any discussion of the relative merits of specific products) with respect to any of these annuity options, we could be dealing with several contracts for a single initial conversation with one client. This scenario, at least with regard to variable annuities, also raises concerns about the required signatories to the contract, which is discussed in the next section.

[28] Proposed BIC Exemption, Section II(a).

NAIFA urges the Department to also consider that it would take a substantial amount of time and resources for advisors to "paper" their existing clients (sometimes hundreds of clients for a single advisor) with new contracts. NAIFA members estimate that getting new contracts in place will require, for 77% of clients, face-to-face conversations and explanations about the new requirement. In other words, simply mailing out contracts and requesting returned signed copies is not a feasible option for the vast majority of our clients. NAIFA encourages the Department to be mindful of this reality and draft its final rule in such a way that any new contract requirement will not bring on-going services to existing clients to a complete halt while contracts are developed, circulated, explained, and signed.

Finally, the Department should consider an omnibus implementation strategy for existing clients. Specifically, the Department should allow advisors to send notices to their existing clients stating that the advisor has a fiduciary obligation to act in the client's best interest. As discussed above, such a notice would be binding on the advisor, but would mitigate the burden of obtaining signed contracts with every client. To the extent the Department retains a formal contract requirement, however, a good-faith effort to get executed contracts in place for all existing clients within a reasonable amount of time should satisfy any such requirement.

b. Only one financial institution signature should be required on any contract.

The proposed BIC exemption requires that the contract be signed by the advisor, the financial institution for which the advisor acts as agent or registered representative, and the investor. NAIFA is concerned that, under the proposed exemption, our members' contracts may require four signatories.

"Financial institution" is defined under the proposal as the entity (including a registered investment adviser, a bank, an insurance company, or a broker-dealer) that employs the advisor "or otherwise retains such individual as an independent contractor, agent or registered representative." This structure is especially problematic for variable annuity products, which have both insurance and securities features. When selling these products, our members are appointed by the insurance carrier and are registered representatives of the broker-dealer.[29]

Thus, based on our reading of the proposed BIC exemption, it appears our advisors would need to obtain signatures from both the broker-dealer and the insurance carrier each time they even *recommend* a variable annuity product. And if they recommend multiple variable annuity products, the proposal would require multiple contracts (for the same client and the same discussion), signed by the respective carriers of each recommended product, the advisor, the broker-dealer, and the investor. This simply is not a workable requirement.

Any contract requirement should be satisfied with the signature of the registered representative, her broker-dealer, and the investor, and should not have to include the carrier's signature. Requiring each carrier's signature portends an excessively burdensome process. Thus, NAIFA

[29] On the other hand, fixed annuities are insurance contracts that provide guaranteed lifetime income and do not have a securities component. Thus, when selling fixed annuity products, advisors act as agents for insurance carriers and there are no broker-dealer relationships involved. *See* Annuity Compensation Models, attached hereto as Exhibit 2(b).

asks the Department to clarify in its final rule that any contract need only be signed by the investor, the advisor, and one financial institution (i.e., in the case of securities products, including variable annuities, the advisor's broker-dealer; in the case of fixed annuities, the insurance carrier).

c. Advisors should not have to provide warranties regarding financial institutions' incentive and compensation arrangements.

The proposed BIC exemption requires advisors to warrant that the financial institution (or any affiliate or related entity) does not use differential compensation or any other actions or incentives that would tend to encourage individual advisors not to act in the best interest of their clients. This warranty effectively undermines any compensation-related benefits an advisor could receive for complying with the BIC exemption. According to the Department, the BIC exemption is designed to allow financial professionals to continue receiving compensation that is ubiquitous in the marketplace (e.g., commissions, 12b-1 fees, revenue sharing, etc.). But this warranty requirement forces those professionals to effectively promise not to employ any of those common compensation arrangements in the first place.[30]

Moreover, this warranty is duplicative. Under the contract requirement, advisors must affirmatively state that they are acting as fiduciaries and in the best interest of the client. The best interest standard is in place to address the very problem presumably targeted by this warranty. Thus, NAIFA urges the Department to remove this warranty requirement from the final rule.

To the extent some version of this warranty remains in the final rule, NAIFA notes that registered representatives generally do not have the information necessary to make such a blanket warranty about the compensation and incentive practices of the financial institution for which they are an independent agent or registered representative. Therefore, NAIFA asks the Department to make clear in its final rule that any such warranty must be made by the financial institution, not the advisor.

d. Advisors should be permitted to limit the scope and duration of the fiduciary relationship.

BIC exemption contracts may not include "provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms."[31] Department officials stated at the May 7, 2015 technical briefing that they do not intend for this provision to bar advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the scope of services the advisor is willing to provide to a given client or the time period

[30] The Department's examples in the preamble of acceptable compensation arrangements (i.e., arrangements that would not violate this warranty) indicate that the Department is forcing everyone to flat-fee and wrap account arrangements. For the reasons discussed in the introduction to this comment letter, those arrangements will not benefit NAIFA members' clients.

[31] Proposed BIC Exemption, Section II(f)(1).

during which such services will be provided). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) that limits the duration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail ongoing advice (i.e., a one-time sales relationship), the advisor should be able to make clear that the fiduciary relationship encompasses only the sale, and the advisor does not have perpetual fiduciary obligations to the client. Further, advisors should be able to clarify the scope of (or disclaim) any ongoing monitoring obligations. NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a notice to the client.

2. *Advisors' disclosure obligations should be reduced.*

The proposed BIC exemption requires an advisor, prior to the purchase of any asset, to furnish the investor with a chart that provides, for each asset recommended, the "total cost" to the investor of investing in the asset for 1-, 5- and 10-year periods expressed as a dollar amount (using reasonable assumptions about investment performance). "Total cost" includes loads, commissions, opening fees, sub-transfer agent fees, etc. NAIFA interprets this provision to require growth projections for recommended products, which conflicts with current securities regulations.[32] At the May 7, 2015 technical briefing Department officials acknowledged this conflict and represented that they would resolve the issue in the final rule.

Aside from the conflict with securities laws, NAIFA has several general concerns about this type of disclosure requirement (i.e., projecting costs into the future). First, any cost projections—especially when put in a dollar amount—will be inherently unreliable because an advisor simply cannot predict what will happen with the market or with a given asset. Second, advisors' compensation, which is largely controlled by upstream financial institutions, can change at any given time, especially when compensation is based on an advisor's total book of business. Thus, any cost disclosure should be expressed in general terms (e.g., gross dealer concessions), not an actual dollar amount, and should not isolate advisor compensation from other entities' compensation (e.g., break out the broker-dealer and advisor portions of a shared commission). Third, a disclosure requirement of this nature would be very costly and burdensome for small, independent advisors. And fourth, as discussed in greater detail below, investors may not actually benefit from extensive disclosures of this nature.

In addition to the transaction-level total cost disclosure, the proposed BIC exemption includes obligatory annual disclosures, which are to be provided by the advisor or the financial institution for which the advisor is an agent or registered representative. We believe this annual requirement is duplicative and overly burdensome in light of the proposal's transactional disclosures and should be removed from the final rule. If the requirement is retained, however, NAIFA strongly encourages the Department to clarify that this particular obligation falls on the financial institution, and not the individual advisor. Advisors will not have access to the information subject to this disclosure requirement (e.g., total dollar amount of *all* fees paid by the

[32] *See* FINRA Rule 2210(d)(1)(f) (prohibiting performance predictions and projections).

investor, directly or indirectly, and *all* compensation received by the advisor and financial institution, which includes compensation paid to parties upstream from the advisor—fees about which the advisor would not be aware). And again, the burden of the disclosure requirement will be particularly heavy for independent advisors without back office support.

Regardless of which entity ultimately is responsible for making these disclosures, under the Department's proposal, investors will be inundated with complex charts and figures and duplicative information. This could result in heightened consumer confusion and no real consumer benefit. According to a LIMRA Secure Retirement Institute Survey published in May 2015, disclosures do not necessarily help investors grasp how much they are paying in fees or for what they are paying.[33] The survey asked participants in 401(k) plans about their perceptions about fees before and after disclosures were made and concluded that participants' understanding did not improve with disclosure, and half of those surveyed could not say how much they pay in fees following disclosure.[34]

Advisors and financial institutions already make product-specific disclosures to their clients under securities regulations and existing Department regulations like those under section 408b-2 (which, apparently, have limited usefulness). Increasing the cost and burden on advisors by adding unnecessary, confusing disclosures will not help retail investors. Accordingly, NAIFA recommends that the Department significantly narrow the disclosure requirements under the BIC exemption and, to the greatest extent possible, integrate any such requirements with existing client notices and disclosures.

D. Limited Product Offerings

NAIFA supports the Department's allowance under the BIC exemption for financial institutions and advisors to offer a limited range of investment options (e.g., proprietary products). The Department should clarify, however, that advisors who are not licensed to deal in securities products can offer, as a general rule, a broad enough variety of products to satisfy the best interest standard (i.e., just through the offering of non-securities insurance and annuity products). Department officials said at a meeting on May 20, 2015 that their intention was not to exclude entire groups of advisors with the best interest standard, and indicated that advisors without securities licenses would be able to satisfy the BIC exemption's requirements.

E. Special Exemption for Insurance and Annuity Products

NAIFA also supports the Department's proposed special exemption for insurance and annuity products, which allows advisors to recommend insurance and annuity products from insurance companies that are parties in interest. This special exemption is necessary for NAIFA members who are affiliated with, or captives of, insurance companies. It is NAIFA's understanding that the special exemption's relief is limited to certain party-in-interest (or in the case of IRAs, disqualified person) prohibited transaction rules, and does not extend to prohibited transaction

[33] LIMRA Survey, at 17.

[34] *Id.*

rules regarding conflicted compensation received by the advisor.[35] Thus, we interpret the proposal to require an advisor who receives compensation prohibited under ERISA or the Code to rely on the larger BIC exemption or PTE 84-24, depending upon the investor and transaction in question, to receive such compensation. NAIFA encourages the Department to elucidate the interaction between the special exemption and the broader PTEs in the final rule.

III. PROHIBITED TRANSACTION EXEMPTION 84-24

A. PTE 84-24 should apply to all annuity products sold to all types of investors.

The Department's proposed PTE 84-24 creates a convoluted compliance structure under which annuities transaction are divided between securities and non-securities products, and by the type of investor involved in the transaction (i.e., IRAs and plans). Under the proposal, PTE 84-24 will no longer be available for variable annuity or mutual fund sales to IRAs; to sell those products to IRA owners, advisors will have to rely on the more onerous BIC exemption. However, if those same products are sold to plans, PTE 84-24 still applies. For the following reasons, the Department should adopt a more balanced approach and retain 84-24 relief for all insurance and annuity products sold to all types of investors.

First, this structure is unnecessarily complicated and confusing. The proposed PTE 84-24, like the BIC exemption, requires advisors and financial institutions to adhere to impartial conduct standards, including the best interest standard, and to fulfill robust disclosure requirements.[36] It is not clear why the Department feels that some products for some investors should be split off and handled under a separate compliance scheme.

Second, as noted above, NAIFA members are compensated similarly for fixed and variable annuity products (i.e., through an upfront commission). To the extent the Department is concerned about different conflicts of interest arising from different compensation models, that concern is misplaced.

Third, the more complicated the compliance regime, the more costly it will be for advisors, financial institutions, and ultimately, consumers.[37] In this case, the Department's proposed

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[35] The "covered transactions" provision under the special exemption provides relief from specified ERISA § 406(a) rules and from Code § 4975(c)(1)(A) and (D), but does not include 406(b)-type relief.

[36] To the extent 84-24's conditions match the BIC exemption's conditions, NAIFA incorporates the same comments and suggestions made earlier in this comment letter.

[37] It is worth noting that annuity products are already subject to multiple layers of regulation. Because they are insurance products, they are heavily regulated at the state level. States have product content and marketing rules in place, as well as sales practices requirements. Additionally, the NAIC has model regulations (adopted by almost all of the states) on disclosures and suitability in annuity transactions. And of course, at the federal level, the SEC and FINRA regulate the sale of variable annuities. The Department should not add on top of this structure another complex, confusing and costly layer of regulation.

structure places a heavier burden on advisors who serve IRA owners, and particularly, on advisors who sell variable annuity products to those investors. As previously discussed in this letter, annuity products are generally sold to low- and middle-income investors who rely on the income stream from those products, and variable annuities are especially attractive to investors who desire those products' upside potential. Once again, the Department is actually disadvantaging middle market consumers by forcing their advisors to adhere to more onerous and costly requirements under the BIC exemption.

B. PTE 84-24 should cover the purchase by SIMPLE and SEP IRAs of variable annuities and mutual funds.

The Department proposes to revoke PTE 84-24 for the purchase by Individual Retirement Accounts of annuity products that are securities and mutual fund shares. "Individual Retirement Account" is defined broadly to include "individual retirement accounts" and "individual retirement annuities" described in 26 U.S.C. §§ 408(a) and (b), respectively. Subsections 408(k) and (p) then define SEP and SIMPLE IRAs as employer-sponsored "individual retirement accounts" or "individual retirement annuities" (as described in subsections (a) and (b)) with specific participation, contribution and other requirements.[38]

The Department should not revoke PTE 84-24 for SIMPLE and SEP IRA purchases of variable annuities and mutual funds. These employer-sponsored IRAs are akin to traditional pension plans in that they are retirement savings vehicles established for the benefit of individual employees. Because they have fewer reporting requirements and are easier to administer, these types of plans are especially popular with small employers.

As drafted, the Department's proposal unfairly burdens advisors who sell SIMPLE and SEP IRAs to employers (i.e., small employers) instead of traditional 401(k) plans because they are forced to rely on the more onerous BIC exemption in order to place variable annuities and mutual funds in these plans.[39] This discrepancy between requirements for different types of employer-sponsored retirement savings plans is not warranted.

The investment advice services provided to employers who adopt SIMPLE and SEP IRAs are the same as the services provided to employers who adopt 401(k) plans (i.e., evaluation of the employer's particular needs, recommendations about plan types, and recommendations about investment options offered through the plan). To the extent NAIFA members advise employers on plan and menu design and receive some variable or third-party compensation for their services (i.e., do *not* use the common employer fee model described in detail at the beginning of this letter), they should be able to rely on PTE 84-24, regardless of the type of retirement plan in place.

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[38] Section 408(c) provides that "a trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries . . . shall be treated as an individual retirement account (described in subsection (a))" if the governing instrument creating the trust meets certain requirements.

[39] As a practical matter, fixed annuities are not sold to employer-sponsored retirement plans of any type.

Like recommendations made to employers with 401(k) plans, investment advice given to employers with SIMPLE and SEP IRAs is a step removed from recommendations pertaining to the employees' ultimate investment decisions. With the help of an advisor, the employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising between the advisor and a plan of any type is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved.

Accordingly, advice to employers regarding plan and menu design should be covered under PTE 84-24 and not the more onerous BIC exemption, regardless of whether the advisor is selling group annuity or mutual fund products and regardless of whether the employer chooses to offer a traditional 401(k) plan or a SIMPLE or SEP IRA to its employees.

C. PTE 84-24's compensation relief should be expanded.

1. *PTE 84-24's compensation relief should be coextensive with the BIC exemption's relief.*

For transactions that are covered under the proposed 84-24, the Department has limited compensation relief to agents, brokers and principal underwriters to narrowly-defined "Insurance Commissions" and "Mutual Fund Commissions." Unlike current PTE 84-24, the proposal explicitly excludes revenue sharing, administrative fees, marketing payments, and payments from parties other than the insurance company or its affiliates. The Department's justification for such restrictions on compensation relief under 84-24 (and not imposing such restrictions under the BIC exemption) is unclear.

Proposed 84-24 imposes the same "best interest" standard as that under the BIC exemption, as well as other impartial conduct standards and disclosure requirements. The mandate that advisors act in the best interest of their clients should assuage concerns the Department may have about particular compensation arrangements. Thus, the Department should extend 84-24's compensation relief to be coextensive with the BIC exemption's relief.[40]

2. *PTE 84-24's compensation relief should at least be extended to include mutual fund commissions for agents.*

If the Department opts to not extend 84-24's relief to match the BIC exemption's relief, the Department should—at the very least—extend 84-24's coverage to include Mutual Fund Commissions paid to Principal Underwriters *and their agents.* As drafted, the proposed PTE 84-24 allows for payment of insurance commissions to insurance agents and brokers, but does not allow agents or registered reps to receive commissions for mutual fund sales, even though the

[40] It is our understanding that the special exemption for insurance and annuity products contained under the BIC exemption provides relief from ERISA and Code party in interest/disqualified person rules, whether the transaction falls under the BIC or 84-24 for conflicted compensation relief. Again, we request that the Department clarify this point in its final rule.

same impartial conduct standards and exemption conditions apply equally to the sale of insurance and annuity products, and mutual funds. Without any apparent justification, the Department's proposal allows agents to be paid for one product line, but cuts off their compensation for another.[41] The Department should remedy this discrepancy by allowing agents to be compensated for mutual fund sales.

IV. THE DEPARTMENT SHOULD EXTEND THE ENFORCEMENT TIMELINE TO AT LEAST THIRTY-SIX MONTHS

The proposed eight-month enforcement timeline for compliance with the new rule is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

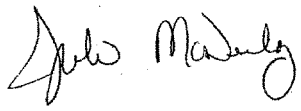
The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

Each one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

[41] Agents and brokers are paid almost exclusively on a commission basis for the sale of mutual fund shares.

Very truly yours,



Juli Y. McNeely, LUTCF, CFP, CLU
NAIFA President 2014-2015

Exhibits: NAIFA Comment Letter on Proposed Rule
Diagrams of Compensation Models
LIMRA Secure Retirement Institute 2015 Consumer Survey
Principal Funds Table on Asset Class Performance from 1994 to 2013

Exhibit 1
NAIFA Comment Letter on Proposed Rule

National Association of Insurance and Financial Advisors

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July 21, 2015

VIA ELECTRONIC FILING – www.regulations.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department") proposed definition of fiduciary "investment advice" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[1]

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

BACKGROUND & EXECUTIVE SUMMARY

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[2] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

[1] NAIFA has filed a separate comment letter on the Department's proposed prohibited transaction exemptions, which is attached hereto as Exhibit 1.

[2] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Many of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of conducting their business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in more detail below, NAIFA has significant concerns about the workability of some portions of the Department's proposed rule, and recommends several adjustments to the proposal. Namely, NAIFA strongly encourages the Department to adopt a final fiduciary investment advice definition that:

- Requires some investor reliance on the investment advice;
- Requires a mutual understanding between the investor and the advisor;
- Excludes referrals to other financial professionals;
- Excludes distribution-related advice that is not investment advice;
- Excludes welfare benefit plans with no investment component;
- Excludes, or includes a carve-out for, marketing and sales activity for all products, services and investors;
- Includes a carve-out for advice relating to employer plan design;
- Allows for meaningful investor education by including a broad education carve-out;

- Allows advisors to place reasonable limitations on the scope and duration of the fiduciary relationship; and
- Includes an enforcement timeline of at least thirty-six months.

In its current form, the proposed rule presents major—and in some cases, insurmountable—obstacles for NAIFA members serving middle-market retail investors (i.e., those who need the most encouragement and assistance when it comes to retirement savings). NAIFA hopes that the objective of the Department's proposal is not to limit or take away advisory services for Main Street investors, and we greatly appreciate your thoughtful consideration of these comments.

I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[3] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[4] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[5] Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[6]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed

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[3] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[4] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[5] *Id.*

[6] *Id.*

rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[7] And small businesses that work with a financial advisor are 50%

[7] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[8] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[9] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[10]

B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
>
> (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
>
> (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets

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Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

[8] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 2.

[9] Oliver Wyman Study, at 6.

[10] LIMRA Survey, at 13.

they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[11] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[12] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and

[11] Oliver Wyman Study, at 6.

[12] *Id.*, at 7.

dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[13] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

[13] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

II. THE PROPOSED RULE

Virtually all NAIFA members will be investment advice fiduciaries for purposes of ERISA and the Code under the Department's proposed rule. The rule, along with the Department's proposed PTEs, will require major changes in our members' business practices and client relationships. While NAIFA is not opposed to a "best interest" standard of care for advisors, it is extremely important that such a standard be contained within a feasible operational structure.

As it stands, nearly all of our members who become fiduciaries will have to alter their current compensation arrangements (for at least some clients and some products) or satisfy a PTE. For the reasons discussed above, both options carry significant risk of harm to retail investors. We believe that such risk can be partially mitigated, however, if the Department addresses the specific points of concern discussed below.[14]

A. Scope of the Proposed Definition of Fiduciary "Investment Advice"

1. *The definition of fiduciary investment advice should require some investor reliance on the investment advice.*

The Department's current five-part test for fiduciary investment advisors includes a requirement that the advice serve as the primary basis for the investment decision(s) ultimately made by the investor.[15] The requirement ensures that clients actually act on the investment advice before a fiduciary relationship arises. NAIFA strongly urges the Department to maintain a similar reliance requirement under its proposed definition of fiduciary investment advice. Otherwise, advisors are forced to take on a fiduciary role, even if their investment advice is completely

[14] Again, NAIFA has submitted separate detailed comments on suggested adjustments to the Department's PTE proposals.

[15] *See* 29 CFR 2510.3-21.

ignored or has no impact whatsoever on the client's investment decisions. Given the substantial cost and burden on fiduciaries under the Department's proposal, fiduciary relationships should at least be limited to situations in which some meaningful advice or service is rendered *and* accepted.

2. *The definition of fiduciary investment advice should require a mutual understanding between investor and advisor.*

Similarly, the Department's current fiduciary investment advice test includes a requirement that the advice be given pursuant to a mutual agreement or understanding between the investor and the advisor.[16] Mutual understanding, like reliance, should be an element of the Department's new definition of fiduciary investment advice. Before a fiduciary relationship exists, both parties should, at a minimum, recognize that the advice is being given and considered for the client's particular investment needs. Without such mutuality, casual or social conversations could be misconstrued as fiduciary communications. Again, considering the burden of the overall fiduciary structure proposed by the Department, some common-sense checks should be in place before fiduciary obligations are imposed on advisors. At the very least, the impacted parties should have an awareness and understanding of what they are undertaking.

3. *Recommendations of other financial professionals should not fall within the definition of fiduciary investment advice.*

As drafted, the Department's proposed definition of fiduciary investment advice covers four general categories of advice:

> (1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including a recommendation to rollover assets or take a distribution);
>
> (2) A recommendation as to the management of securities or other property (again, including rollover and distribution decisions);
>
> (3) An appraisal, fairness opinion, or similar statement—verbal or written—concerning the value of securities or other property when provided in connection with a specific transaction; and
>
> (4) A recommendation of a person who is also going to receive a fee or other compensation for providing the aforementioned types of advice.

The last category—recommendations of other financial professionals—should be excluded from the fiduciary investment advice definition because it is not *investment* advice. In fact, a simple referral is several steps removed from actual investment activity. The Department's definition appears to assume that the recipient of the advice will in fact pursue the recommended professional, that the other professional to whom the prospective client is referred will be in a position (and agree) to work with the client, and that investment advice will actually be given and acted upon.

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[16] *Id.*

Furthermore, inclusion of referrals under the new definition of fiduciary investment advice will effectively eliminate referrals because advisors simply will not be willing to take on fiduciary obligations in situations where the "advice" rendered is to send the investor elsewhere for services. And reducing referrals will harm investors. Professional referrals are a valuable service, particularly to unsophisticated investors or those who are new to retirement planning and saving. A list of names or advertisements in a phone book does not offer any meaningful guidance for investors to narrow down their options or find professional services that are suitable for them. Referrals from individuals in the same business, however, provide investors with some confidence that they will be talking to a reputable advisor who, in at least someone's estimation, is an appropriate advisor for the investor.

The Department's proposal to include referrals in the definition of fiduciary investment advice defies logic and will only harm consumers. Accordingly, the Department should remove this category of advice from the proposed definition.

4. *Advice regarding distributions—without accompanying investment advice—should not be included in the definition of fiduciary investment advice.*

As noted above, the Department proposes to include advice regarding distributions under the definition of fiduciary investment advice. This type of advice should be excluded, however, when it is rendered without any accompanying *investment* advice. For example, if an advisor is informed that an investor has suffered an unforeseeable financial loss and needs to take a hardship distribution—and there is no investment recommendation sought or given pertaining to the distributed funds—the advisor's non-investment advice aimed at facilitating the distribution should not qualify as fiduciary investment advice. Similarly, if an advisor counsels an investor not to take a distribution (i.e., to preserve the status quo with respect to plans and assets), that also should not be considered fiduciary advice.

In these scenarios, the advisor is not delivering advice with respect to particular investments from which the advisor may benefit, but rather is providing generic counseling and assistance for the good of consumers. Thus, the Department should clarify in the final rule that such distribution-related advice is not considered fiduciary investment advice.

5. *Welfare benefit plans with no investment component should be excluded from the rule.*

The Department's proposed rule defines "plan" as "any employee benefit plan described in section 3(3) of [ERISA] and any plan described in section 4975(e)(1)(A) of the Code." Section 3(3) of ERISA includes employee pension benefit plans and employee welfare benefit plans, which include health, life, and disability benefits. Department officials indicated at a meeting on May 20, 2015, and during a phone conversation on June 3, 2015, that the Department does not intend the proposed rule to cover welfare plans that do not have an investment component (i.e., plans that are not designed to generate income or increase wealth). NAIFA strongly urges the Department to clarify in its final rule that benefit plans like traditional health, life and disability are not covered under this rule-making.

NAIFA suggests achieving such clarification by adding a definition of "other property." For example, the definition could read:

> "'*Other property*' for purposes of this section does not include welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

Alternatively, the term "investment" could be defined as follows:

> "'*Investment*' for purposes of this section does not include the purchase, sale, holding, or exchanging of welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

In addition to these specific suggestions, there may be other ways for the Department to resolve this issue. NAIFA urges the Department to clarify, in one way or another, that welfare benefit plans with no investment component are not covered under this rule-making.

6. *Marketing of services and preliminary client development conversations should not be considered fiduciary investment advice.*

For the individuals and small businesses served by NAIFA members, effective marketing of our advisors' services can mean the difference between an employer offering a retirement plan or not, or an individual prematurely cashing out a retirement account or continuing to save. Getting good advice to consumers who need it is a goal we all share. Further, as discussed above with respect to professional referrals, we all agree that consumers should be able to make informed decisions when choosing their advisors.

Department officials said at a technical briefing on May 7, 2015 that they did not intend to capture conversations along the lines of "hire me" or "these are the services I can offer you" under the definition of investment advice. At that same briefing, officials acknowledged that there should be some opportunity for preliminary conversations with prospective clients before fiduciary status and any attendant contract or disclosure requirements are triggered. Secretary Perez echoed those comments while testifying before a congressional committee on June 17, 2015, where he stated that the Department wants consumers to be able to "shop around" and "[the Department's] goal is to make sure that shopping around can happen." However, given some elements of the proposed rule, NAIFA believes that these sentiments need to be clarified and memorialized in any final rule.

As drafted, the proposed rule applies to a recommendation:

> (1) of a person who is going to receive compensation for providing investment advice;
>
> (2) that is individualized or specifically directed to the recipient of the recommendation; and

(3) is provided by someone who may eventually receive compensation as a result of the recommendation.[17]

It appears that this would cover one-on-one sales pitches and targeted advertising by advisors seeking to introduce their services to new clients, which creates an unnecessary barrier to services for individuals and employers who will not sift (or do not feel comfortable sifting) through anonymous advisor listings in the phone book.

The Department could ensure that these initial conversations are not captured by adopting some of the above suggestions (e.g., by requiring some investor reliance and mutual understanding between advisors and investors). Or, as discussed in detail below, the Department could resolve this issue by creating a robust seller's exception. Regardless of the approach taken, NAIFA urges the Department to carve out marketing and preliminary conversations with prospective clients from the investment advice definition.

B. The Department should Adopt a Seller's Exception that Applies Across all Products, Services, and Investors.

The Department's proposed seller's exception (the counterparty carve-out) does not apply to small plans or IRAs at all, and is limited to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract to large plan ("sophisticated") investors.[18] As drafted, the exception also does not appear to cover a discussion about an advisor's services.[19] The Department should replace its proposed counterparty carve-out or create a separate seller's exception that applies to all products, services, and investors.

A robust seller's exception will allow advisors and financial institutions to market their products and services. Marketing, as opposed to true investment advice, poses very little threat of conflicts of interest. Presumably, this is why marketing has not historically been considered fiduciary activity under ERISA or the Code. Indeed, it is unclear whether the Department has statutory authority to capture pure marketing and sales activities under the fiduciary umbrella.

Sales pitches in the financial advisor context are like sales pitches in all other retail contexts; they are take-it-or-leave-it promotions designed to attract consumers in the first instance so that products and services can *then* be delivered. And like other retail contexts, financial advisor marketing should not be limited to certain segments of the population. The Department appears to believe—without apparent justification—that small business owners (i.e., with 99 or fewer employees) are not as sophisticated as large business owners (i.e., with 100 or more employees).

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[17] *See* proposed § 2510.3-21(a)(1)(iv) (what constitutes investment advice), (a)(2)(ii) (the requirement that said advice be directed to an individual), and (f)(6) (definition of "fee or other compensation, direct or indirect").

[18] *See* proposed § 2510.3-21(b)(1)(i).

[19] Because the counterparty exception applies only to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract, it is NAIFA's interpretation that it does not cover a discussion of services.

Size of a business is immaterial, however, to the financial knowledge and sophistication of a plan fiduciary. Furthermore, there is no evidence that financial sophistication is needed to understand when someone is making a sales pitch rather than delivering impartial advice. The Department's paternalistic approach is misguided, and will only prevent a large number of consumers from learning about available products and services, which is counterproductive for the retirement crisis in this country.

Any seller's exception could and should include reasonable investor protections, such as clear and explicit disclosures by the advisor that she is not providing impartial or fiduciary investment advice (i.e., the disclosure required under the proposed counterparty exception), but rather is engaged in marketing or sales activity. A full disclosure of this nature supports the Department's objective of improving consumer awareness of advisors' obligations (or lack thereof) in certain circumstances. At the same time, a broad exception allows for effective marketing and client development, which will help advisors reach those populations that are arguably in most need of professional retirement planning assistance.

C. The Final Rule Should Include a Carve-Out for Advice on Plan Design.

An advisor's assistance to employers with menu design for participant-directed plans (including 401(k) plans, SIMPLE IRAs, and SEP IRAs) should be excluded from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products.[20] Thus, the risk of a conflict of interest arising at this stage between the advisor and employee investors is minimal. Furthermore, in the plan design space, the plan administrator—regardless of plan size—*is* under a separate obligation to make informed and prudent decisions with respect to the plan.[21]

The "plan design exception" should apply when an advisor is providing recommendations to an employer:

> (1) On the types of retirement plans available (e.g., 401(k), SIMPLE IRA, etc.), and associated costs and benefits with respect to plan types;
>
> (2) On the investment options that will be made available through the plan selected (e.g., mutual fund options, annuity options, etc.), including advice related to the overall allocation of investment options and advice related to narrowing down options within general product categories; and

[20] NAIFA recognizes that individualized investment advice to plan participants or IRA owners is a different scenario with separate conflict-of-interest concerns.

[21] *See* 29 U.S.C. § 1002(21)(a)(iii) (under ERISA, a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of such plan); *see also* 26 U.S.C. § 4975(e)(3)(C) (corresponding fiduciary definition under the Code).

(3) On plan administration topics, including selection of a managing fiduciary, third-party administrators, and other administrative service providers.[22]

Employers need professional advice in each of these areas to establish and maintain a retirement plan appropriate for their specific needs and employee populations. As explained above, a plan design exception is consistent with the Department's goal of minimizing advisor conflicts of interest, as well as the overarching objective of encouraging individuals to save early for retirement by increasing the availability of employer-sponsored retirement plans.[23]

D. The Final Rule Should Allow for *Meaningful* Investment Education.

During a meeting on May 4, 2015 with NAIFA members, Department officials stated that one of their objectives is to preserve investor education. And Secretary Perez told members of Congress on June 17 that investor education is "exceedingly important." Unfortunately, the narrow scope of the education exception under the proposed rule will not facilitate the goal of preserving or expanding investor education. It will have the opposite result, especially for unsophisticated investors who benefit the most from such education.

Secretary Perez commented on June 17 that, in his view, the "most important part" of an educational discussion between advisor and investor "is the asset allocation conversation." And, he asserted that, under the proposed rule, those conversations do not trigger fiduciary status or obligations. The Secretary's comment is perplexing, to say the least, when one reads the proposal's narrow education exception.

There are approximately 9,000 mutual funds available today, not to mention the host of other types of products available in the retirement space. Telling an inexperienced investor to choose among mutual funds without providing any guidance as to the strength or desirability of any particular funds is not meaningful education; it is simply overwhelming. Meaningful education requires some identification and characterization of specific investment options.

The Department has not historically restricted "education" to generic, high-level conversations. Instead, the Department has allowed for meaningful education to take place, with appropriate disclosures. For instance, under Interpretive Bulletin 96-1,[24] the Department has not included within fiduciary "investment advice" asset allocation models that identify specific investment

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[22] We do not interpret the Department's proposed platform provider carve-out to be broad enough to capture these advisor services. To the extent the Department does intend for the carve-out to cover these activities, NAIFA urges the Department to make that clear in the final rule.

[23] Alternatively, if the Department chooses not to include a plan design exception, NAIFA urges the Department to finalize a more robust PTE 84-24 that would cover plan design services and advice. This alternative approach is described in more detail in NAIFA's comment letter on the Department's proposed PTEs, attached hereto as Exhibit 1.

[24] 29 CFR Part 2509.

alternatives, as long as they are accompanied by a statement indicating that other investment options with similar characteristics may be available. Bulletin 96-1 reasons: "Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a "recommendation". . . and, accordingly, would not constitute [fiduciary investment advice]."[25]

The Department's rationale in Bulletin 96-1 makes perfect sense and its approach strikes an appropriate balance between ensuring the availability of meaningful investment education and providing investor protection. NAIFA strongly encourages the Department to maintain its current rule on investment education and create an education exception under its proposed rule that encompasses this broader, more helpful approach.

E. Advisors Should be Permitted to Put Reasonable Limitations on the Scope and Duration of the Fiduciary Relationship.

Department officials stated at the May 7, 2015 technical briefing that they do not intend the proposal's prohibition on exculpatory contractual language[26] to prohibit advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the time period and scope of services the advisor is willing to provide to a given client). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) regarding the expiration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail the provision of ongoing advice (e.g., a one-time sale relationship), the advisor should be able to make clear that the fiduciary relationship concludes with the sale and the advisor does not have perpetual fiduciary obligations to the client.[27] NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a disclosure to the client.

III. The Department Should Extend the Enforcement Timeline to at least Thirty-Six Months

The eight-month enforcement timeline for compliance with the new rule proposed by the Department is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about

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[25] *Id.*

[26] *See* Proposed BIC Exemption, Section II(f)(1).

[27] A contractual term of this nature would not bar suit by the investor based on breach of fiduciary duty or interfere with any current statutes of limitation with respect to such claims.

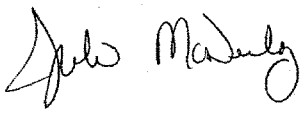
the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

Each one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

Very truly yours,



Juli Y. McNeely, LUTCF, CFP, CLU
NAIFA President 2014-2015

Exhibits: NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions
LIMRA Secure Retirement Institute 2015 Consumer Survey

Exhibit 2

Diagrams of Compensation Models

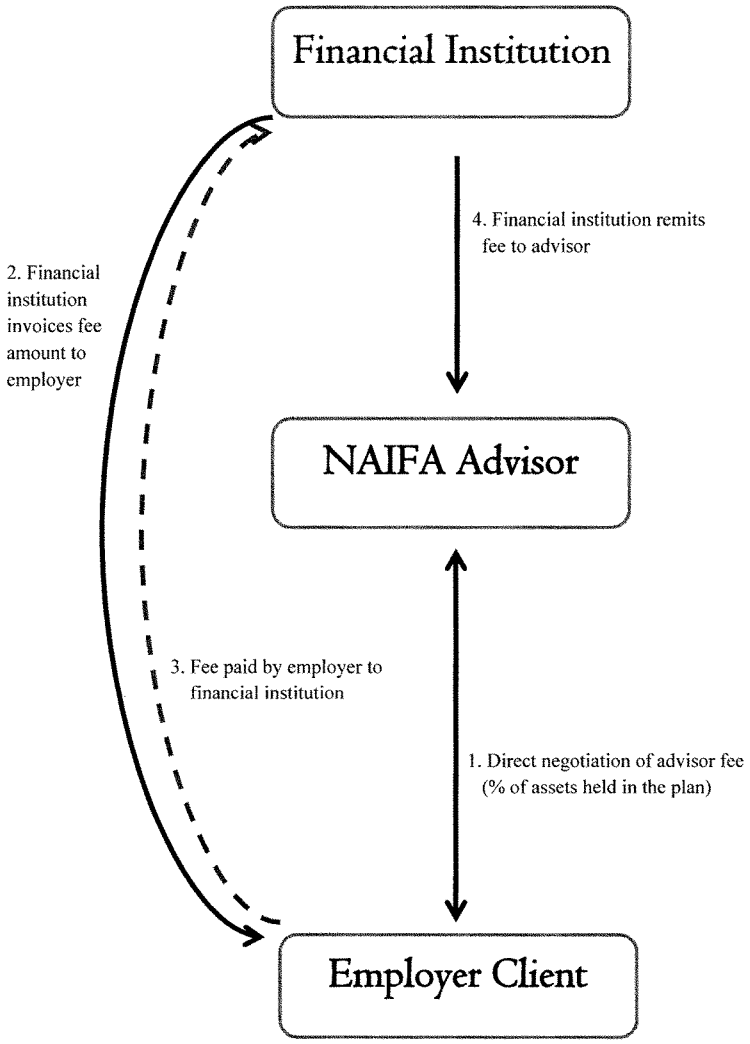
(a) Employer Plan Model

(b) Annuity Models

EXHIBIT 2(a)

Employer Plan Compensation Model

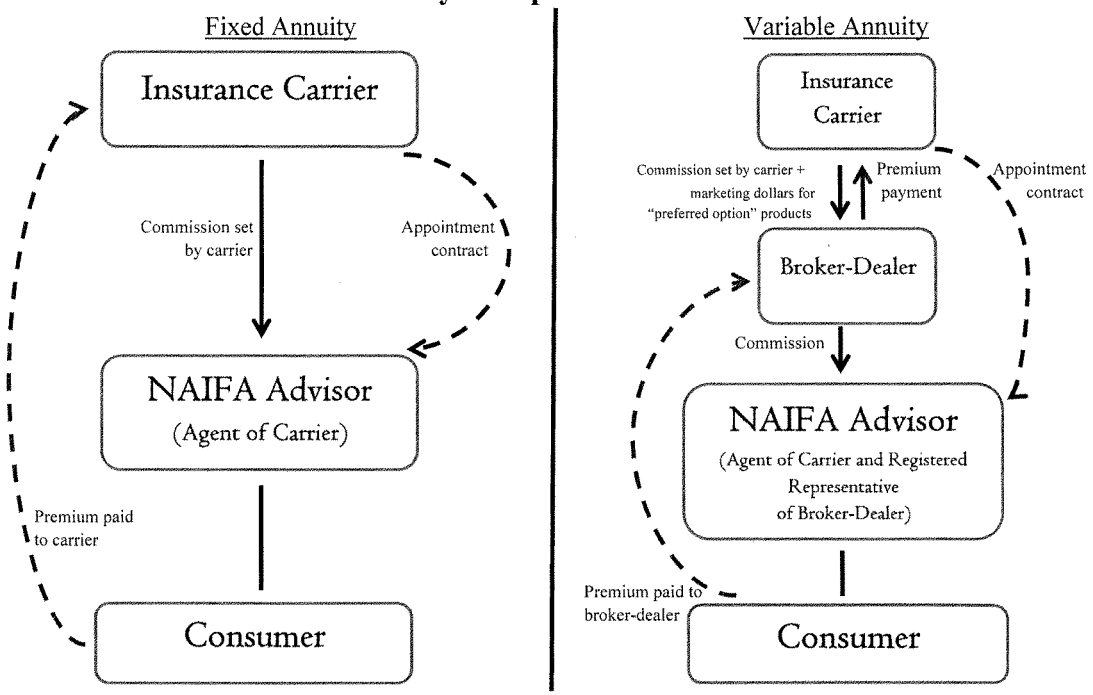
(401(k), Simple IRA, etc.)



This diagram represents a common fee arrangement for NAIFA members. It is not meant to depict all compensation scenarios in the employer plan space.

EXHIBIT 2(b)

Annuity Compensation Models



These diagrams represent common fee arrangements for NAIFA members.
They are not meant to depict all compensation scenarios in the annuity product space.

Exhibit 3

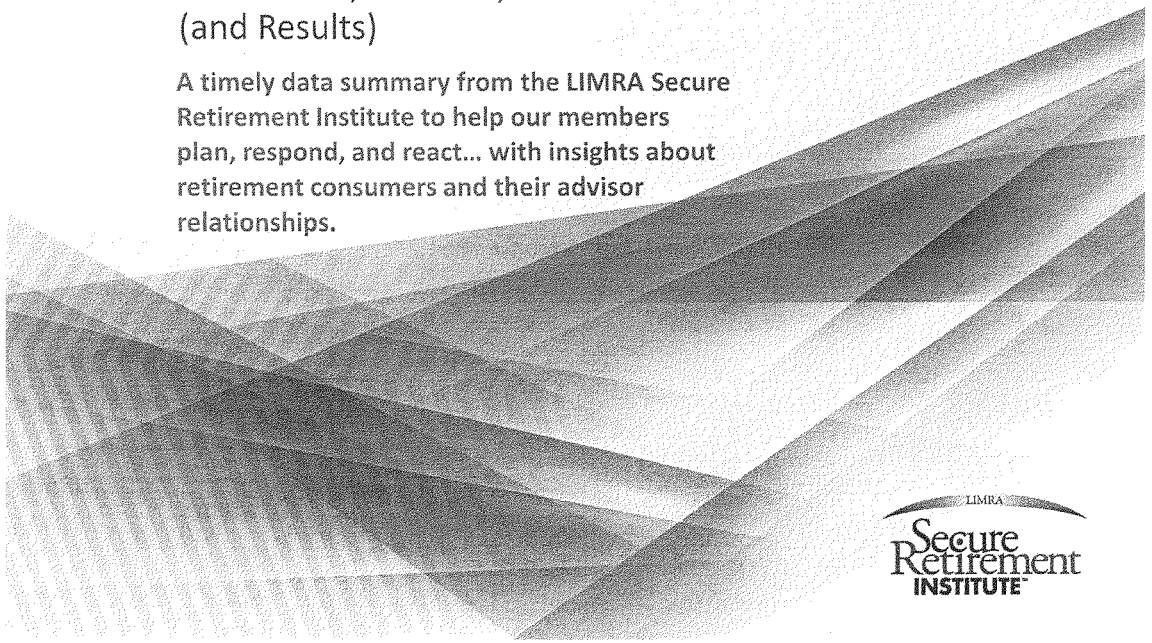
LIMRA Secure Retirement Institute 2015
Consumer Survey

May, 2015

Matters of Fact

Consumers, Advisors, and Retirement Decisions (and Results)

A timely data summary from the LIMRA Secure Retirement Institute to help our members plan, respond, and react… with insights about retirement consumers and their advisor relationships.



LIMRA Secure Retirement INSTITUTE

In This Document

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- Advisors Are Linked to Better Results: In-Plan (DC) 4
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- Advisors Encourage Other Regular Savings Activities 6
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NOTE: Throughout this report, the term "Advisor" refers to a paid financial professional (e.g. broker, financial planner or advisor) used to make at least some of household investment decisions.

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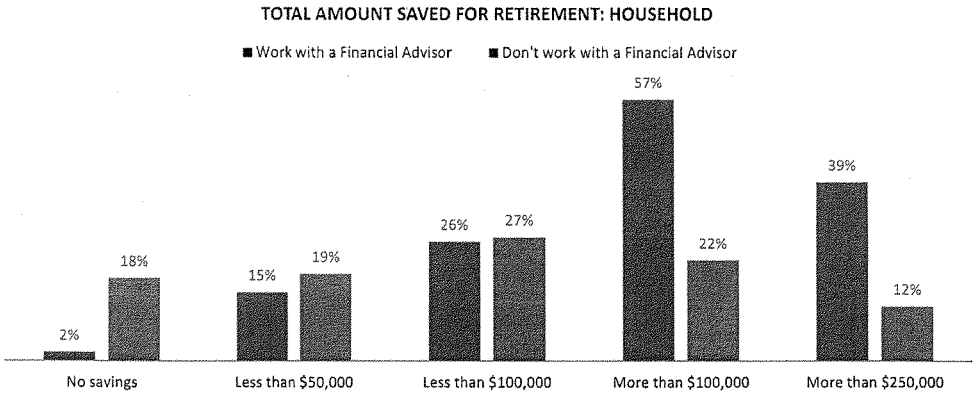
Advisors Are Linked to Better Results: Total Retirement Savings

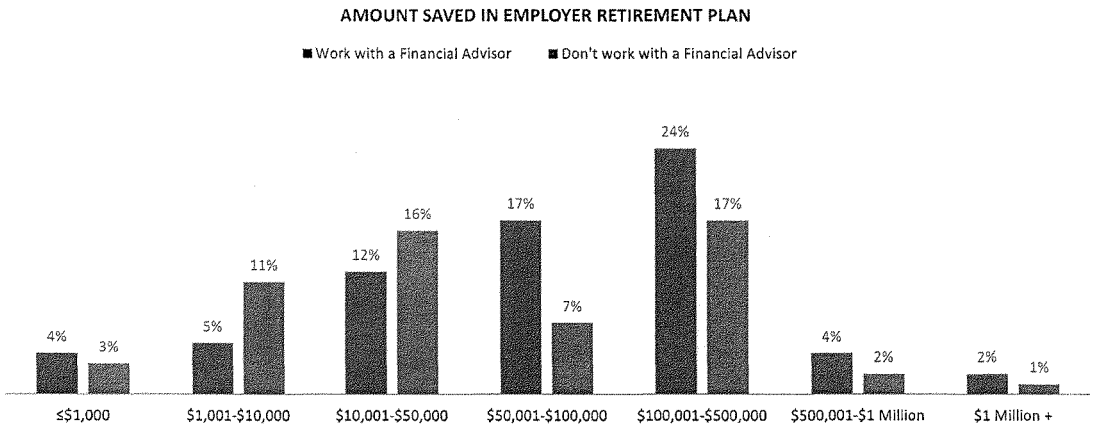
Households that use financial advisors are three times as likely as non-advised households to have $250,000 or more in retirement savings … and are more than twice as likely to have $100,000 or more.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Advisors Are Linked to Better Results: In-Plan (DC)

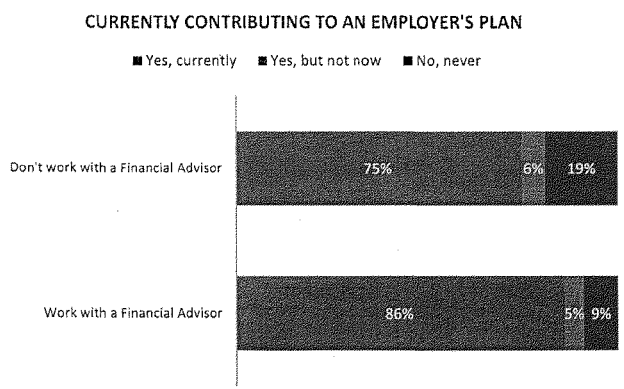
People who engage financial advisors have higher retirement account balances in employer retirement plans.

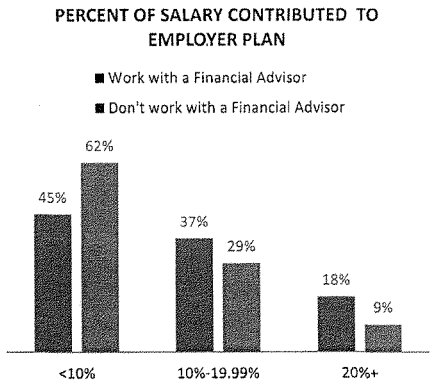


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

People With Professionals Are More Engaged in Employer Plans

People who work with financial advisors are more likely (than those who do not) to participate in their employers' DC plans. More of those with advisors also demonstrate "good" behavior — contribute 10 percent or more to their employers' plans (and are twice as likely to contribute 20 percent or more).

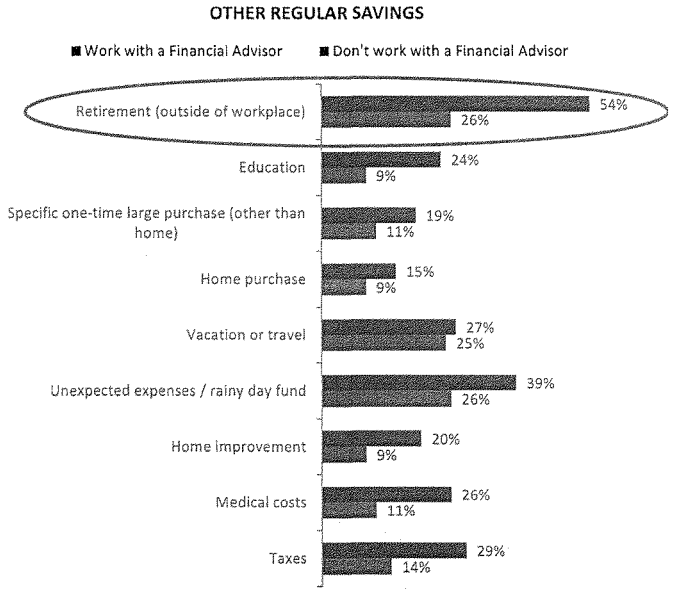




Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

People who Consult Professionals Save Regularly for a Variety of Goals

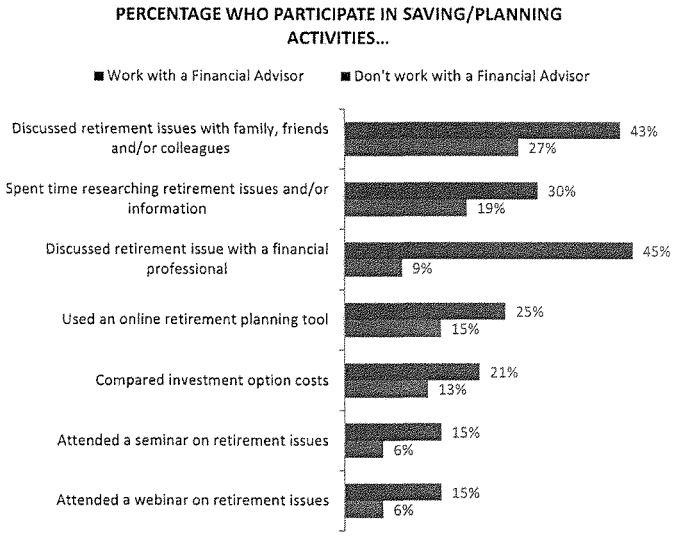
Advisors can also add value by encouraging clients to save holistically, not just for retirement. For nearly every listed savings goal (except vacation), advisors' clients are significantly more likely to save on a regular basis compared with people who don't consult advisors.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Advisors are Associated with Engagement and Activity

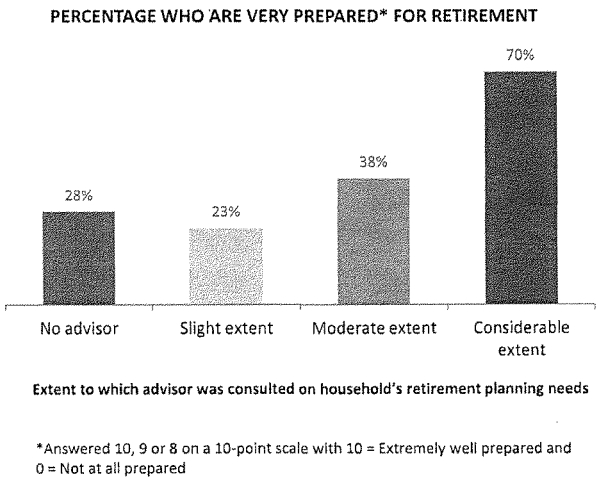
Advisors can help their clients engage with their own retirement and financial lives. People who use advisors are more likely to discuss their retirements with a range of individuals, from family to financial professionals; and, to conduct basic planning activities such as attending seminars and webinars, and using planning tools.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

Pre-Retirees' Preparedness Linked to Degree of Advisor Reliance

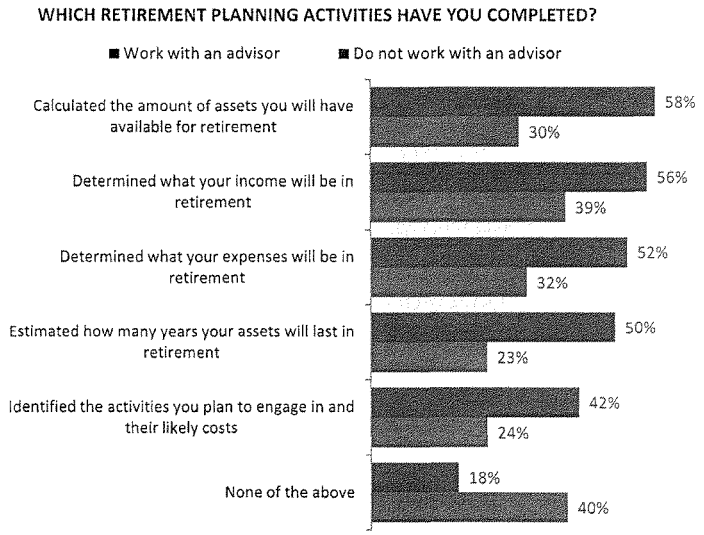
People who use an advisor – especially to a considerable extent – are significantly better prepared for retirement than those who don't consult an advisor, or who do so only slightly.



Source: *Advisor Perspectives on Retirement Planning*, LIMRA Secure Retirement Institute, 2012

Using an Advisor Tracks with Increased Engagement

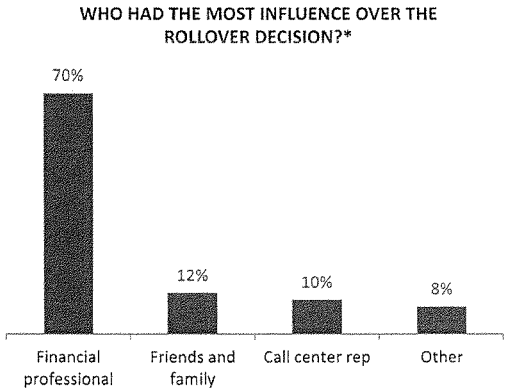
Pre-retirees who work with financial professionals are more likely to complete key planning activities.



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

IRA and Rollover Decisions Are Not Purely a Function of Fees

Financial professionals/advisors are highly influential in helping individuals to make informed rollover decisions.

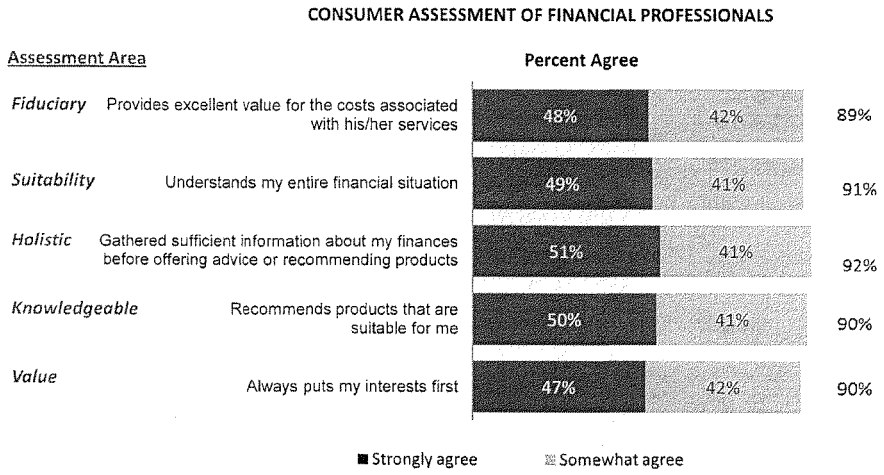


*When consumers near retirement or recently retired (aged 55 to 70) rolled money from a DC plan into an IRA and spoke with someone about their decision.

Source: LIMRA Secure Retirement Institute 2014 Rollover Consortium

People Value Their Advisors

Consumers feel that advisors look out for their best interests, and understand their own needs and goals.

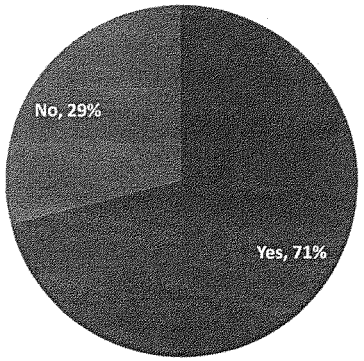


Source: *Quarterly Consumer Sentiment Q2 2015,* LIMRA Secure Retirement Institute.

Disclosure Does Not Improve Participant Knowledge About Fees

Even after disclosure, most participants think DC plan fees and expenses are reasonable... but few pay a great deal of attention to disclosure when delivered.

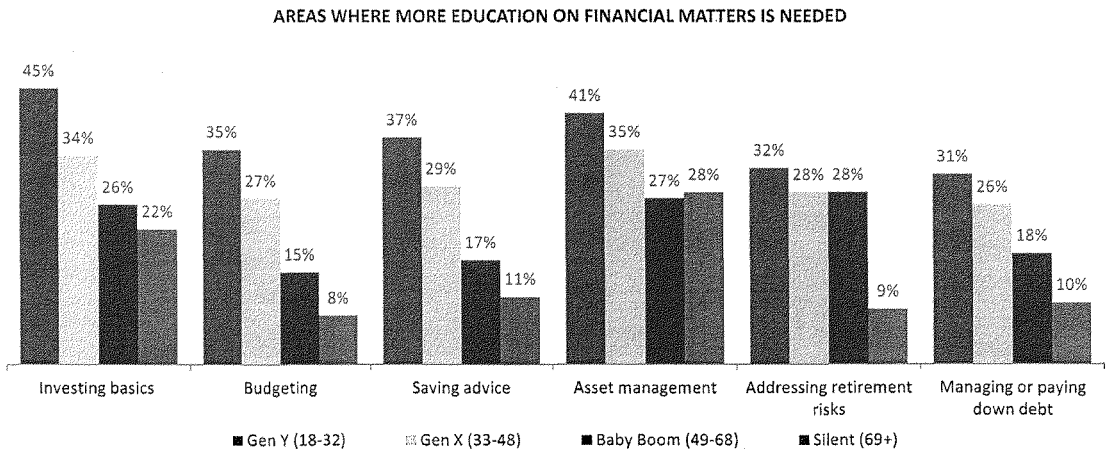
PERCENT WHO AGREE THAT DC PLAN FEES/EXPENSES ARE REASONABLE



Source: *Deciphering Disclosure,* 2013, LIMRA Secure Retirement Institute

Consumers Want More Education

Many consumers, especially younger ones, say that they need additional guidance on matters critical to financial security and retirement planning.



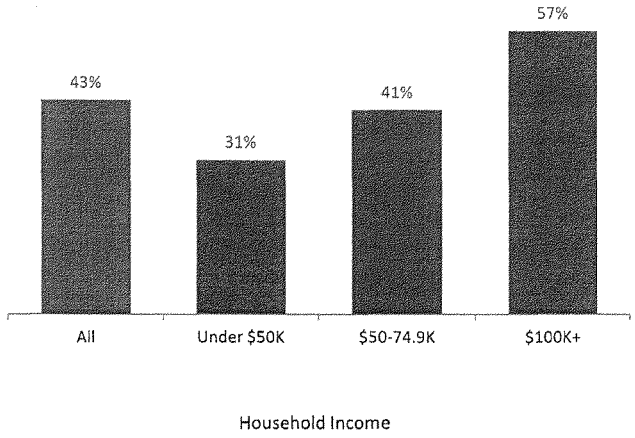
Source: *Third Quarter 2013 Consumer Perspectives,* LIMRA Secure Retirement Institute.

A Majority of Consumers Do Not Take an Active Role in Managing Their Assets

Only 4 in 10 consumers are actively engaged in managing their assets.

Even among high-net-worth consumers, only 6 in 10 actively manage their assets.

PERCENTAGE OF PEOPLE WHO ARE VERY INVOLVED WITH MONITORING AND MANAGING THEIR RETIREMENT SAVINGS.



Sources: *Financial Triage Assessing Consumer Wellness (2015)* and 2014 Consumer Survey, LIMRA Secure Retirement Institute

"Best Interests" Differ Based on Attitudes and Preferences

Consumers with similar demographic profiles, wealth levels, and lifestyle ambitions may have very different preferences and financial priorities. Because their attitudes toward money differ, we developed three consumer segments based on the income solutions they prefer.

Three money mind-sets:

- **Guarantee Seekers** – Want to know that their income won't disappear. Have a floor of lifetime guaranteed income and would be interested in converting even more of their savings to a pension-like contractual guarantee. Want to spend money without the day-to-day worry of how long it has to last. Want the peace of mind of a certain outcome.
- **Estate Planners** – Financially savvy. Understand that equity markets generally out-perform risk-free fixed investments. Can withstand a little volatility to maximize the potential of investments. Trust their own investment decisions. Want to maintain personal control over investment decisions and to retain the flexibility to adjust income and spending as needs change over time.
- **Asset Protectors** – Have been saving money for a long time. Do not want to see savings account balance decrease. Will live off the interest and dividends of savings, but are uncomfortable invading principal. Don't want to be "poorer."

Source: *A New Perspective on Retirement Income*, 2015, LIMRA Secure Retirement Institute

Additional Facts and Research Data

- Controlling for household wealth, individuals who work with paid financial professionals are more likely to have formal, written retirement plans and to be confident that they are on track with their retirement savings.
- Confidence in being able to live their desired lifestyle in retirement is higher among those working with paid financial professionals, particularly for less-wealthy households.
- Among pre-retiree households with less than $500,000 in financial assets, there is a significant difference in subjective levels of retirement preparedness between those who work with financial professionals and those who do not work with financial professionals.
- Individuals who work with paid financial professionals are twice as likely as those not working with paid financial professionals to say that they had a discussion reviewing the pros and cons of doing a rollover to an IRA versus leaving the money in the plan.
- For pre-retirees (aged 55 to 70), the most common reasons involve consolidation of assets, gaining greater control over their money, seeking better returns, not wanting to leave their money with their former employer, and access to a greater range of investments.
- Pre-retirees say their desire for consolidation, better returns, and control most influenced their rollover decisions. Fees were not a significant factor.
- Seeking lower fees is not a major motivator, regardless of who had the greatest influence.
- Despite regulatory concern over conflicts of interest, 9 in 10 consumers agree that their financial professional always puts their interests first.
- Nine in ten agree that their financial professionals provide excellent value for the costs associated with their services. This assessment does not vary based on compensation method.
- Half of consumers who work with a financial professional have worked with their advisor for more than five years.
- Two thirds of consumers had a financial professional help with their rollover decision. Seven in ten consumers say the discussion they had with the financial professional about the advantages and disadvantages of the options they could take with their retirement plan assets was helpful.

Additional Facts and Research Data (Continued)

- DC participants don't spend a lot of time reading their statements. Most people spend less than 10 minutes with their statements.
- The Institute asked participants about their perceptions of 401(k) fees before and after disclosure. People don't have a good grasp of what they were paying, before or after. Despite receiving a fee disclosure notice, half of DC participants can not say how much they pay in fees.
- DC participants are generally satisfied with the value for cost.
- Only one third of consumers have a long-term financial plan. One in three have a monthly household budget.
- Slightly more than half of consumers have neither. Only 19 percent of consumers have both a short-term budget and long-term financial plan.

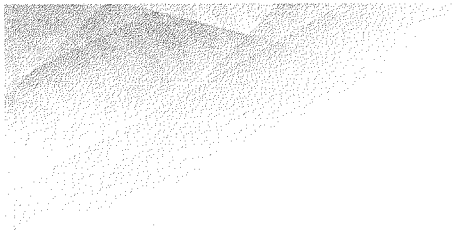


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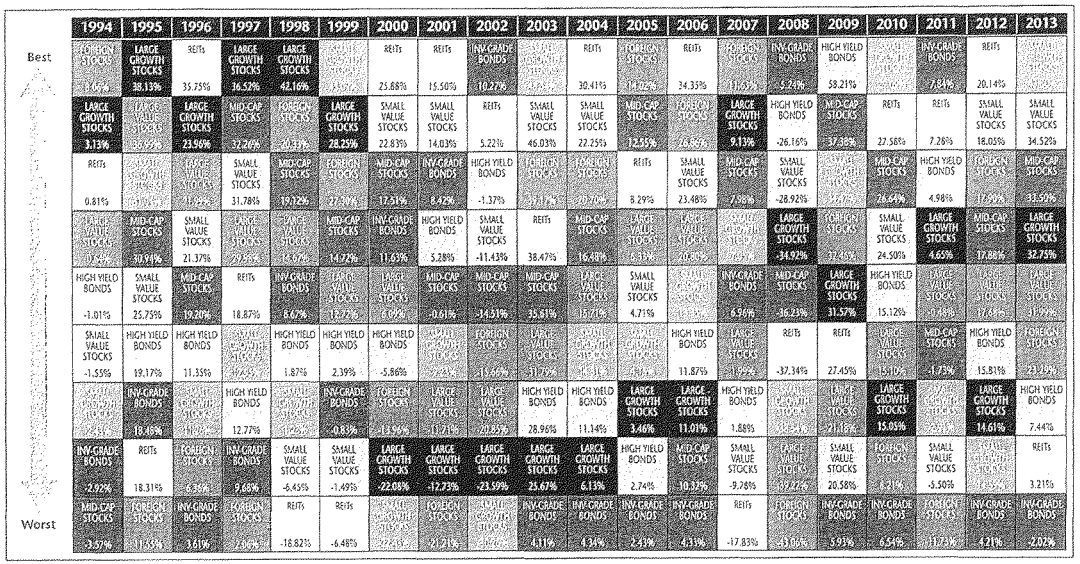
Exhibit 4

Principal Funds Table on Asset Class
Performance from 1994 to 2013

Still trying to time the market? Take a closer look.

This table demonstrates how various asset classes have performed on an annual basis from 1994 through 2013. As you can see, the best performing asset classes change dramatically from year to year. Since no one can predict the future, diversification is critically important to help you reach your investment goals.



Past performance is not a guarantee of future results.

Source: Zephyr StyleADVISOR. Small value stocks are represented by the Russell 2000® Value Index; small growth stocks are represented by the Russell 2000® Growth Index; large value stocks are represented by the S&P 500/Barra Value Index for 1994–2005 and by the S&P 500/Citigroup Value Index for 2006–2013; large growth stocks are represented by the S&P 500/Barra Growth Index for 1994–2005 and by the S&P 500/Citigroup Growth Index for 2006–2013; mid-cap stocks are represented by the S&P MidCap 400 Index; foreign stocks are represented by the MSCI EAFE Index; REITs are represented by the FTSE NAREIT All REITs Index; high yield bonds are represented by the Barclays Capital U.S. Corporate High-Yield Index; investment-grade bonds are represented by the Barclays Capital U.S. Aggregate Bond Index. This material has been obtained from sources generally considered reliable. No guarantee can be made as to its accuracy. Not intended to represent the performance of any particular investment. Indices are unmanaged and one cannot invest directly in an index.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Principal® Funds

- Large Growth Stocks
- Large Value Stocks
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- Small Growth Stocks
- Small Value Stocks
- Foreign Stocks
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STATEMENT

OF

PAUL SCHOTT STEVENS
PRESIDENT & CEO
INVESTMENT COMPANY INSTITUTE

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT-SPONSORED ENTERPRISES
AND
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

ON

PRESERVING RETIREMENT SECURITY AND INVESTMENT CHOICES FOR ALL AMERICANS

SEPTEMBER 10, 2015

EXECUTIVE SUMMARY

The key points covered in the body of my statement are summarized below.

The Department's Proposed Rule Is Fundamentally Flawed

- **The Institute supports a best interest standard.** The Institute fully supports the principle at the heart of the Department's proposal—financial advisers should act in the best interests of their clients when they offer personalized investment advice. But the added layers of unwarranted complexity and ambiguity that the Department proposes to pile on top of that simple best-interest principle creates the risk that many savers—and particular, lower- and middle-income individuals and small businesses—will receive *no* advice or service, or none that they can afford. We expect that the proposed rule, if adopted, will make retirement saving *more* challenging and costly for many retirement savers, particularly those with modest balances.

- **The Department's proposed rule will adversely impact retirement savers.** Under the Department's proposed rule even the most basic information—such as that offered in many common call-center and web-based interactions—could trigger ERISA fiduciary status and prohibited transactions. To provide a workable framework for its proposed rule, the Department must allow service providers to continue to offer meaningful investment education to retirement savers without inadvertently triggering fiduciary status.

- **The Best Interest Contract (BIC) exemption is unworkable.** The Department purportedly designed the proposed BIC Exemption to permit broker-dealers and others to continue to receive variable compensation, such as commissions and front-end loads, notwithstanding their status as an ERISA fiduciary. Under the BIC Exemption, however, a financial services provider must comply with a series of unworkable conditions. Through the BIC Exemption, the Department proposes to convert the fiduciary principle into a series of compliance traps and barriers for financial advice professionals and their firms. Further, the "grandfather" rule for existing transactions included in the BIC Exemption would unnecessarily harm investors by prohibiting ongoing advice on assets acquired prior to the rule's applicability date. Finally, we cannot emphasize enough that the proposed applicability date does not provide sufficient time for the extensive system and policy changes needed to comply with the BIC Exemption. If the Department moves forward with this rulemaking, it must propose a workable structured implementation of the Exemption's conditions over an appropriate number of years and must adopt a "good faith" compliance mechanism, consistent with previous regulatory initiatives.

- **The Institute has provided the Department with constructive recommendations for fixing the proposal's flaws.** The Institute fears that the Department's proposal as currently drafted will create real harm—a loss of access to information and advice—to America's retirement

savers. The Institute has counseled the Department in detailed comment letters on the many serious flaws that collectively make the Department's proposal simply unworkable and has provided numerous constructive suggestions for improving the rules as proposed.

The Department's Regulatory Impact Analysis, like the Proposed Rule, Is Fatally Flawed

- **The Department's claims that broker-sold funds "underperform" are not supported by the very academic studies on which it relies.** The Department relies on certain academic studies to support its claims that investors are harmed by their use of brokers. None of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. Further, these studies rely upon outdated data (from the 1990s to roughly 2004) that fail to reflect fundamental changes in the market for broker-sold funds in the past 10 years. Finally, the Impact Analysis misapplies the findings of a key study, leading to a vast overstatement of the potential benefits of the rule.

- **Investors' actual experience with broker-sold funds contradicts the Department's claims.** Specifically, publicly available data from 2007 through 2013 demonstrate that, contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category. On a sales-weighted basis, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. Similarly, publicly available data show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads—further contradicting the Department's claims that brokers are systematically not acting in the best interests of clients.

- **The RIA ignores the economic impact of moving investors to fee-based accounts.** The total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year. By way of contrast, a recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses. We estimate that moving investors to fee-based accounts will have a net cost, cumulatively over 10 years, of $47 billion.

- **The RIA fails to account for the societal harm of investors losing access to advice and guidance.** Fee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements (frequently, $100,000). Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals. We calculate that the 10-year cost of lower returns caused by such errors would be

$62 billion. Indeed, the Institute estimates that retirement investors' returns could be reduced, conservatively, by $10.9 billion a year—or $109 billion over 10 years—as a result of the additional fees and lost returns they will incur.

I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute[1] and I am pleased to appear before the Subcommittees today to discuss our shared objective of promoting retirement security and preserving investment choices for all Americans. In particular, my statement will address the nature and implications of the U.S. Department of Labor's proposal to redefine the term "fiduciary" in the context of providing investment advice under the Employee Retirement Income Security Act of 1974 ("ERISA"). Chairmen Garrett and Duffy and Ranking Members Maloney and Green, thank you for this opportunity to share our views and for the attention that you and your colleagues are paying to this rule proposal and the way in which it will impact the efforts of millions of working Americans to save and invest for retirement.

The mutual fund industry is especially attuned to the needs of retirement savers because mutual funds hold about half of retirement assets in defined contribution (DC) plans and individual retirement accounts (IRAs).[2] While we certainly embrace the principle at the heart of the Department's proposal – that all financial advisers must be held to act in the best interests of their clients – the proposal itself is deeply flawed. Regrettably, if adopted in anything like its current form, the rule would do great harm to retirement savers by drastically limiting their ability to obtain the guidance, products, and services they need to meet their retirement goals. It also will increase costs, particularly for those retirement savers who can least afford it.

As it reviews the Department's rule proposal, this House Financial Services Committee also is considering H.R. 1090, the "Retail Investor Protection Act," a bill introduced by Representative Wagner and Chairman Garrett. H.R. 1090 reflects a commonsense goal of ensuring that federal agencies work to adopt a harmonized fiduciary duty for all investors and that they do so in a manner that does not jeopardize investor access to personalized and cost-effective investment advice. Simply put, H.R. 1090 reflects a strong purpose – one shared by the Institute – to get the fiduciary rules right.

In an array of letters and comments, Members of Congress from both parties have expressed concern with numerous aspects of the Department's rule proposal and urged a variety of important

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[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.2 trillion and serve more than 90 million U.S. shareholders.

[2] At the end of the first quarter of 2015, U.S. retirement assets totaled $24.9 trillion, DC plan assets were $6.8 trillion, and IRA assets were $7.6 trillion. Investors held $3.6 trillion of IRA assets and $3.8 trillion of DC plan assets in mutual funds. *See* Investment Company Institute, *The U.S. Retirement Market, First Quarter 2015* (June 2015), available at https://www.ici.org/info/ret_15_q1_data.xls.

changes.[3] Labor Secretary Thomas E. Perez has touted the proposal as a principles-based approach to the issue.[4] Were that so, the Institute might be supportive. In fact the Department chose a very different path—it has proposed a set of convoluted, inflexible, and highly prescriptive rules that in no way resembles what Secretary Perez has described.

The many problems with the Department's proposal may well be explained by the fundamental errors apparent in the Department's Regulatory Impact Analysis seeking to justify the massive overhaul of the retirement marketplace it would impose. In particular, this rulemaking – which has been ongoing for years – should have been preceded by a comprehensive cost-benefit analysis. Such an analysis should have sought to demonstrate, among other things, that any restriction on future access to guidance, products, and services is justified in light of a clear problem best solved by an expansive redefinition of fiduciary duty.[5] It also should have considered whether or not less burdensome regulatory alternatives could remedy the problem. The Department's Regulatory Impact Analysis does none of this. Indeed, it altogether fails to consider publicly available data that contradict its conclusions. It likewise fails to consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted.

My testimony today focuses on two key points: First, I will discuss the highly adverse impact the Department's rulemaking proposal will have on the ability of retirement savers—particularly low- and

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[3] *See, e.g.,* Letter from Reps. Ann Wagner (R-MO) and David Scott (D-GA) *et al.,* to the United States Department of Labor, dated July 29, 2015; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN) and Subcommittee on Health, Employment, Labor and Pensions Subcommittee Chairman Phil Roe (R-TN), *et al.,* to the United States Department of Labor, dated July 21, 2015; Letter from Sens. Jon Tester (D-MT) and Angus King (I-ME), *et al.*, to the United States Department of Labor, dated August 6, 2015; Letter from Sen. Claire McCaskill (D-MO), to the United States Department of Labor, dated August 5, 2015; Letter from Senate Finance Committee Ranking Member Ron Wyden (D-OR) and Sen. Debbie Stabenow (D-MI), *et al.*, to the United States Department of Labor, dated August 7, 2015.

[4] In recent testimony, Secretary Perez asserted that the Department, in its proposals, sought to follow a "principles-based approach [that] obligates the adviser to honor the interests of the plan participant or IRA owner, while leaving the adviser and the employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business." Statement of Thomas E. Perez, Secretary, Department, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, U.S. House of Representatives (June 17, 2015), at p. 4, available at edworkforce.house.gov/uploadedfiles/testimony_perez.pdf.

[5] In several letters sent to the Department after the 2010 rule proposal was shelved, Congressional policymakers uniformly expressed the importance of ensuring that any re-proposal of ERISA's fiduciary provision be preceded by a comprehensive regulatory impact analysis. *See, e.g.,* Letter from Reps. James Himes (D-CT), Richard Neal (D-MA), and Carolyn McCarthy (D-NY), *et al.*, to the United States Department of Labor, dated November 7, 2011; Letter from Reps. Gregory Meeks (D-NY) and Gwen Moore (D-WI), *et al.*, to the United States Department of Labor, dated March 15, 2013; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN), House Committee on Ways and Means Chairman Dave Camp (R-MI), Senate Committee on Health, Education, Labor and Pensions Ranking Member Michael Enzi (R-WY) and Senate Finance Committee Ranking Member Orrin Hatch (R-UT), to the United States Department of Labor and the United States Department of the Treasury, dated April 14, 2011.

moderate-income savers—to obtain the guidance, products, and services they need to meet their retirement goals. In this connection, I will describe the changes that the Institute has recommended to the Labor Department in order to make the proposal workable and one that will better serve the interests of retirement savers.

Second, my testimony will demonstrate why the Department's Regulatory Impact Analysis utterly fails to justify its expansive proposal and why, if its rule is adopted, it will do significant net societal harm. Significantly, if the Department adopts the proposed rules without very substantial changes, the Institute estimates that retirement investors' returns could be reduced, conservatively, by $10.9 billion a year—or $109 billion over 10 years—as a result of the additional fees and lost returns they will incur. As we have counseled the Department, we believe strongly that if the Department reassesses its Impact Analysis in light of our comments, it will make policy choices that meet its goals while making its rule simpler, more workable, and better for investors.

II. THE DEPARTMENT'S RULEMAKING WILL HURT – NOT HELP – MILLIONS OF AMERICANS SAVING FOR RETIREMENT

Some of the practical, human implications of the Department's proposal are underscored for me by an experience I recently had helping one of my adult children through a job transition. This is something some of you may have experienced. My son is in his 20s and recently left his first full-time job to take a position with a new company halfway across the country. He was a liberal arts major in college, more a student of history than of finance. And young as he is, his personal financial experience is limited as yet. After he got settled in his new job, we discussed what he might do with the 401(k) balance he had in his former employer's plan. The amount was modest – less than $10,000 – but it was hard earned and if well managed over a long investing horizon it might amount to much more later in his life. Clearly, he wanted to do the right thing but was not sure exactly what that would be. In particular, he needed information that would help him to make a good decision for himself.

I suggested that we call a mutual fund company for information about its products and services, and my son agreed to have me sit in on the conversation. (I suggested a fund company knowing that the amount in question, while important to my son's future, was too small to interest a fee-based investment adviser.) The call center representative of the mutual fund company patiently walked my son through various options, outlining factors relevant to keeping the account in the former employer's plan or rolling it over to an IRA. He explained important investment considerations, like asset allocation and the need for diversification. He also described the various kinds of funds that the fund company offers and how they might help meet my son's savings goals. The conversation with the call center representative certainly validated my son's instinct to keep his modest balance at work for his retirement. But at no time did the representative cross the line and presume to act as an adviser, and the

interaction clearly did not create the relationship of trust and confidence that is characteristic of a fiduciary.

Although my son spent close to an hour talking to the call center representative, the information and help came at no cost to him. But it equipped him to make a good decision, in light of his own situation and preferences. Ultimately, my son decided to rollover his 401(k) plan assets into an IRA and invested those assets in one of the mutual fund company's target date funds, which best matched his decision to concentrate his balances in a single product offering a diversified portfolio of stocks and bonds that adjusts over time.

There are hundreds of thousands of retirement savers like my son in your home states and across our country – young men and women just starting out, people with less financial sophistication for whom help and information are critically important, workers trying to make the most of small accounts. It is essential to ask: how will the Department's proposal impact them?

The answer: the wide net cast by the Department's proposal threatens to eliminate or severely reduce these very types of commonplace exchanges of information—provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Particularly troubling, the proposal would require firms that offer primarily proprietary investment products to forego the ability simply to explain to a retirement saver—like my son—how their products and services may meet the retirement saver's needs.

In the future, such exchanges would have to take place under a cumbersome and convoluted contractual relationship required by the so-called "Best Interest Contract" exemption. As described below, this so-called exemption gives every appearance of having been devised in such a manner that it would never be used. Certainly, it will pose very significant barriers to the type of commonplace interactions described above and no doubt would occasion substantial additional costs.

To be clear, the Institute has been and remains ready to assist the Department in every way possible to get its fiduciary proposal right. We have provided the Department three detailed comment letters on the proposed rule defining the term "fiduciary,"[6] the proposed exemptions in connection with that definition,[7] and the Regulatory Impact Analysis justifying the Department's proposals.[8] A fourth letter I sent to Secretary Perez highlights the key areas of the rule proposal that we believe make it

[6] Letter from David Blass and David Abbey, ICI, regarding the proposed fiduciary rule (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf.

[7] Letter from David Blass and David Abbey, ICI, regarding the proposed best interest contract exemption (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf.

[8] Letter from Brian Reid and David Blass, ICI, regarding the Department's Regulatory Impact Analysis (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf.

unworkable and conveys at a high level the changes we urge the Department to make to the proposed rules.[9] The letters spell out the many serious flaws in the rule proposal that collectively make it hopelessly unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. While I summarize the key changes we recommend later in my testimony, it is instructive to first appreciate just how damaging the Department's rulemaking will be on the ability of savers, like my son, to engage in even the most commonplace of financial interactions.

A. The Department's Overly Expansive and Ambiguous Fiduciary Definition Will Impede Commonplace Financial Interactions That Retirement Savers Now Take For Granted

The Department has proposed criteria for triggering fiduciary status that are far too intrusive and unnecessarily ambiguous. The criteria fails to distinguish between circumstances in which individuals and fiduciaries have a reasonable expectation of fiduciary service and those interactions where there can be no such reasonable expectation. This is a matter of the deepest concern.

ERISA is a uniquely prescriptive statute. It expressly prohibits an ERISA "fiduciary" from engaging in many routine transactions. Most importantly, ERISA prohibits a fiduciary from performing services as a fiduciary that affect the compensation that the fiduciary receives. This prohibition applies regardless of whether the outcome resulting from such services is in the best interest of the recipient. Rules governing what activities give rise to a fiduciary relationship must accordingly provide genuine clarity about who does or does not have that status.[10] These rules must not impede commonplace financial interactions, like the one with my son, and they must allow plans and retirement savers to obtain investments that meet their needs and to gather a range of market input on which to base decisions.

B. The Department's "Best Interest Contract" Exemption (BIC Exemption) Will Not Mitigate The Harm Caused By Its Overly Expansive And Ambiguous Fiduciary Definition

The Department suggests that the impact of its expansive fiduciary definition—like the inability to engage in the kind of helpful interaction that my son experienced—will be mitigated substantially by the BIC Exemption proposed along with its rule proposal. We strongly disagree. That exemption as currently drafted is quite useless because of the multitude of ambiguous and impractical conditions to which it is subject. Thus, for example, the BIC Exemption would require that my son negotiate a three-party written contract and be provided with a mountainous disclosure document before engaging in any conversation with the call center representative. This hardly would create an

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[9] Letter from Paul Schott Stevens, ICI, to Thomas E. Perez, Secretary, U.S. Department of Labor (July 21, 2015) available at www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf.

[10] Testimony of Paul Schott Stevens before the Department (March 1, 2011), available at www.ici.org/policy/ici_testimony/11_dol_fiduciary_tmny.

environment that would encourage a young saver to seek out information from providers about products and services needed to make informed investment choices.

Indeed, it is unlikely that a financial service firm would be inclined to subject itself to the multitude of ambiguous and impractical conditions required of those who wish to rely on the BIC Exemption. The exemption's requirement of a prior contract, its requirements for voluminous fee reporting and disclosure, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation, all totally compromise the usefulness of the exemption. The result will be far reaching. Savers who today rely on brokers and other commission-based advisers for investment services will no longer be able to do so. They will be forced either to engage fee-based advisers, significantly increasing their investment expenses, or to go without information and guidance—the most costly course of all.

Indeed, adopting the current proposals could well reduce the current level of competition in the market by making it more difficult for investors to switch from one fund manager to another or from one financial adviser to another. This outcome would harm not help investors who need and want financial advice to make informed investment decisions—potentially setting back the success of generations of retirement savers and putting at risk our nation's progress on retirement security.

C. "Robo advice" is Not a Panacea for an Unworkable Fiduciary Rule

Secretary Perez insists that it's no problem that financial services firms might find it impossible to continue serving small savers because of new costs and legal risks. He contends that such small savers might be better off working with "robo advisers"—computer-programmed advice delivered on-line—than with human representatives of financial services firms. While online guidance may have a helpful and growing role to play in helping savers, it is dangerous to conclude that such services are a suitable substitute for human interactions in many circumstances. Take my son's situation. He needed someone to take him through the considerations relevant to keeping his account in the plan or rolling it over to an IRA, the concepts of diversification, asset allocation and rebalancing, the various products offered by the provider, and how such products might help meet his savings goals. The exchange of information and ideas offered by a human representative was exactly what he needed.

It is also unlikely that "robo advice" would be a good substitute for the guidance offered by human representatives at financial services firms in times of market downturns or stress. ICI's members reported sharp increases in the volume of investor contacts through their call centers during the sharp swings in equity markets in late August and early September of this year. During episodes such as this or the fall of 2008, an email, text message, or website alert from a "robo adviser" may well not suffice to keep millions of concerned savers from selling into a stressed market, with devastating consequences for their nest eggs.

D. The Institute Recommends Revisions to the Department's Rule Proposal

The Institute's detailed comment letters highlight the many serious flaws that collectively make the Department's proposal simply unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. The key recommended changes identified in our comment letters are as follows:

1. **Draw a commonsense – and clear – line between the provision of fiduciary advice and that of information and education.** Chief among our recommendations is greater clarity regarding what results in the provision of fiduciary advice. The Department must craft the definition of fiduciary advice more carefully to capture only individualized recommendations that are intended for a retirement saver to rely on to take a specific action. We provided alternative text in our comment letter that would accomplish this goal.

2. **Do not treat selling an investment product or service as a fiduciary act.** Small employers, as well as retirement savers generally, should have the option to choose among a wide range of investment products and services. Service providers should be able to provide investors with information and data about those options, both during the sales process and on an ongoing basis. As we demonstrate in our comment letters, there is compelling evidence that Congress did *not* intend for ERISA to disrupt the lawful functioning of the securities markets, to prevent retirement investors from accessing investments, or to turn the "ordinary functions of consultants and advisers" into fiduciary activities.[11] The Department's proposals, at a minimum, should conform to Congress's clear intent in the underlying statute and provide a meaningful seller's exception that covers all savers and applies to true marketing and sales activities.

3. **Modify the "Best Interest Contract" or "BIC" Exemption.** As explained above, and in detail in our comment letters, the BIC Exemption's requirement of a pre-advice contract, its voluminous fee reporting and disclosure requirements, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation, all threaten the usefulness of the exemption. A better approach is to heed Secretary Perez's call to give sufficient flexibility and discretion to allow fiduciaries to determine how best to satisfy their duties in light of the unique attributes of their businesses and, I would add, the needs of investors. If it actually intends the BIC Exemption

[11] *See* ERISA Conference Report, P.L. 93-406, at 323 ("...the ordinary functions of consultants and advisers (other than investment advisers) may not be considered as fiduciary functions...").

to have any practical value, the Department should simplify it as follows:

- ***Take a truly principles-based approach.*** The BIC Exemption will work only if the Department strips it of excessive conditions. A starting point would be eliminating the proposed contractual warranties and representations. They are not needed to protect investors and only serve to expose firms to significant new litigation risk.
- ***Streamline the required disclosures.*** The proposed disclosures needed to qualify for the BIC Exemption are redundant, granular, costly, and unreasonable. As proposed, these disclosures would serve only to overwhelm retirement investors, in the unlikely event that investors actually read them. The Department should revise the disclosure conditions to align them with the far more workable precedents the Department has adopted under ERISA sections 408(b)(2) and 404(a).
- ***Expand the scope of coverage of the BIC Exemption.*** The BIC Exemption contains exclusions and limitations that needlessly harm broad classes of retirement plans and savers. The BIC Exemption takes a "legal list" kind of approach—long ago abandoned by mainstream trust law—in proposing a list of certain favored investment choices and eschewing other investment choices not on the list. As a result, the proposed rules would unnecessarily and inappropriately restrict retirement investors' choices. This is, quite simply, an altogether improper role for the Department or any other regulator, and it should have no place in a final rule. In addition, the Department must expand the BIC Exemption to cover advice provided to all small employers. There is absolutely no sound policy justification for refusing sponsors of small plans access to information and advice about the retirement plans they sponsor and administer.
- ***Eliminate compliance traps.*** The proposed written policies and procedures requirement for "material conflicts of interest" pose insuperable compliance hurdles for advice providers. The Department must clarify and simplify these requirements.

4. **Avoid retroactive application of the rules.** The Department must modify the proposed exemption so that it does not unnecessarily harm retirement savers by prohibiting ongoing advice on assets acquired prior to the rules' implementation dates. Savers who bought investments using the services of a broker, for example, already have paid some form of fee for the advice they received. It would be an absurd, and quite harmful, outcome if the Department's rule results in those savers receiving no further advice for those investments or paying twice for advice (which would be the case if the Department effectively requires

moving the assets, which have already incurred a commission, to an account with ongoing fees).

5. **Provide a meaningful and orderly implementation period.** Even if the Department makes the changes needed to make its rule workable, the rule will be a challenge to implement in an orderly fashion. We strongly recommend that the Department provide an implementation period that allows financial services firms to work with the millions of retirement savers to arrive at an account choice that works best for those savers.

6. **End speculation about special rules for products the Department finds worthy.** The preamble accompanying the proposed BIC exemption suggests that the Department might craft a "streamlined" exemption from ERISA's prohibitions for so-called "high-quality low-fee" investment products is both premature and disconcerting. Not only has the Department failed to provide sufficient information about this aspect of its proposal to allow the public to comment in any meaningful way, but its assumption that a durable, universal definition of investment quality can or should be determined by a federal agency is troubling.

III. THE DEPARTMENT'S REGULATORY IMPACT ANALYSIS DOES NOT SUPPORT ITS PROPOSAL

Given the massive new restrictions on future access to guidance, products and services that would result from the Department's significant regulatory expansion, the Department's Regulatory Impact Analysis (RIA) might be expected to provide compelling and unequivocal evidence of a market failure necessitating an expansive new definition of fiduciary status as well the lack of less burdensome alternatives for remedying the problem. In fact, the Department's RIA is fatally flawed: it simply does not support the Department's assertion that there is a "substantial failure of the market for retirement advice."[12] It also does not properly consider how the proposal actually could limit retirement savers' access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances.

The Department's RIA is based narrowly on the contention that broker-sold funds "underperform," "possibly due to loads that are taken off the top and/or poor timing of broker sold investments."[13] The Department's analysis does not, however, provide a benchmark for returns against which it measures this claim of "underperformance."

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[12] DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), available at: www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at p. 7.

[13] *Id.*, at p. 98.

The Department uses a confusing array of claimed loss estimates. It presents different assessments of what underperformance could cost IRA mutual fund investors based on alternative calculations. Under one calculation, it contends that such underperformance could cost IRA mutual fund investors $18 billion per year[14] – a number close to the claim made by the White House Council of Economic Advisers (CEA) and often cited by Department leadership that "conflicted advice costs Americans about $17 billion in retirement earnings each year."[15]

Regardless of the number used – $17 billion or $18 billion per year – the claims have no basis. The calculations underlying these numbers misinterpret and incorrectly apply the findings of the very same academic research cited as the foundation of the claims, and do not consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted. In fact, these assertions do not stand up when tested against actual experience and data.

Correcting for the Department's many errors and omissions, we find that the Department's proposal, if adopted, will result in net losses to investors of $109 billion over 10 years.

A. The Department's Claims that Broker-Sold Funds "Underperform" Are Not Supported by the Very Academic Studies on Which it Relies

The RIA points to a set of academic studies to buttress its claims that investors are harmed by their use of brokers,[16] but these studies do not support its sweeping claims.

1. The RIA's statement that "[a] wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative"[17] is not supported by the academic research.

There are three overarching problems with using the research cited in the RIA to argue that investors using brokers earn lower returns than if they received advice from a fiduciary.

First, none of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser

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[14] *Id.* at p. 93.

[15] CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at: www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[16] In our comment letter on the Regulatory Impact Analysis ("RIA Letter"), we discuss each of the articles cited by the Department and explain why they do not support these statements. *See* RIA Letter, at pp. 11-16. For reasons of brevity, we do repeat that discussion here. Because it is instrumental to the claims advanced in the RIA, a paper by Christoffersen *et al.* – that purports to measure the cost to investors of investing in funds sold through brokers – is describe in detail below.

[17] *Id.* at p. 7.

that is not a fiduciary. Thus, the findings of underperformance cited in the RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary adviser would experience a different investment outcome than an investor using another financial adviser that is not an ERISA fiduciary.

Instead, these studies seek to measure indirectly how investors fare when receiving assistance from financial professionals who are not fiduciaries, by comparing the performance of funds sold through brokers ("broker-sold" funds) with that of funds sold directly to investors ("direct-sold" funds). The inference that these studies make is that any difference in performance by investors using brokers could be the result of the brokers' conflicts of interest. This is a leap of logic and is not a direct test of the outcomes of using a financial professional that is not a fiduciary (as compared with using one that is a fiduciary).

Second, most of the studies measure the relative performance of broker-sold funds using data from the 1990s and early 2000s. Fundamental changes in the mutual fund markets since that time have made these studies out of date. Fifteen to twenty years ago, mutual fund markets were segmented, with little head-to-head competition between broker-sold funds and direct-sold funds or funds that did not charge a load ("no-load" funds). Several of the academic papers argue that this segmentation led to broker-sold funds having weaker competitive pressures to produce returns.[18]

Reliance on these studies ignores significant changes in the mutual fund markets. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes (Illustration 1).[19] By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds.

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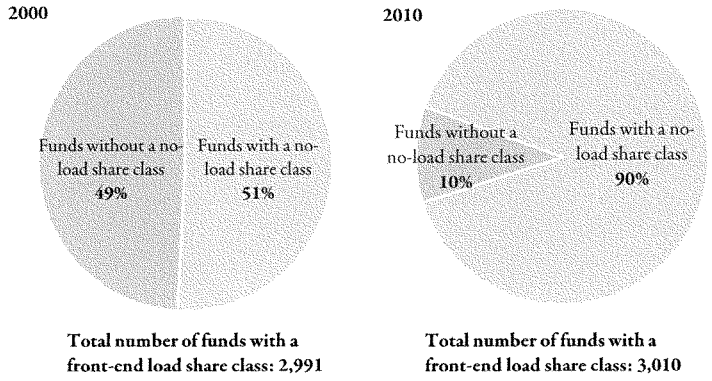
[18] *See* Daniel Bergstresser, John Chalmers, and Peter Tufano. "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry." *Review of Financial Studies* 22, no. 10 (2009): 4129-4156; Diane Del Guercio, and Jonathan Reuter. "Mutual Fund Performance and the Incentive to Generate Alpha." *Journal of Finance* 69, no. 4 (2014): 1673-1704; and Christoffersen, Evans, and Musto (2013).

[19] Throughout the comment letter, we exclude money market funds, variable annuities, and funds of funds. Money market funds constitute less than 0.1 percent of front-end load fund assets at year-end 2014. Including funds of funds would have created double counting in some of analysis, so we excluded them in all of the analysis. Funds of funds account for 6.6 percent of the front-end load fund assets.

Illustration 1

Front-End Load Funds with No-Load Share Classes Have Risen Since 2000

Percentage of funds with a front-end load share class; 2000 and 2010



Total number of funds with a front-end load share class: 2,991

Total number of funds with a front-end load share class: 3,010

Note: The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds (funds of funds).

Sources: Investment Company Institute and Lipper

A third challenge with the literature is that only one study that the RIA cites (Bergstresser *et al.*) assesses the performance of investors using broker-sold funds on an asset-weighted basis. By contrast, the other studies look at individual fund performance. Asset-weighted and sales-weighted returns provide a superior measure of overall market impact by showing how the average dollar invested with a broker-sold fund performs. Another reason for using asset- or sales-weighted returns is that the RIA seeks to measure the proposal's impact on a market-wide basis. Asset- or sales-weighted measures of performance are necessary to make such calculations.

Asset- and sales-weighted performance measures also are useful for determining if brokers are directing investors to lower performing funds. If the asset- and sales-weighted performance of broker-sold funds is below the returns on the average fund, that would provide evidence of brokers steering investors to funds with weaker performance. If, instead, the asset- and sales-weighted performance of broker-sold funds is higher, then brokers are directing clients to funds that outperform, and this would cast doubt on the argument that there is a widespread market failure.

These three problems with the academic literature highlight why it is inaccurate for the RIA to claim that "[a] wide body of economic evidence supports a finding that the impact of these conflicts of

interest on investment outcomes is large and negative."[20] Furthermore, the academic literature does not support the statement that a "careful review of this data ... consistently points to a substantial failure of the market for retirement advice"[21] and "that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 100 basis points per year over the next 20 years."[22]

2. **The RIA's reliance on Christoffersen *et al.* is misplaced.**

The RIA rests heavily on a paper by Christoffersen, Evans, and Musto (2013).[23] As discussed in detail in our comment letter on the RIA,[24] this paper has two fundamental errors that the RIA repeats. These errors present a false impression of the relationship between fund performance and the payments of front-end loads to brokers. Christoffersen *et al.* finds evidence that a subset of funds—those whose front-end loads result in higher broker compensation than can be explained by the average of similar funds—underperformed the average return of their fund category during the next year. The Department, based on an incorrect assumption that all IRA assets that are invested in front-end load funds suffer the same underperformance, erroneously applies this result from a small subset of load funds to all load funds. Once these errors are corrected, the sweeping statements in the RIA about brokers' incentives and investor harm collapse.

These errors, on top of certain other misinterpretations made in the Christoffersen paper, invalidate the RIA's assertion that the typical investment in a broker-sold fund underperforms by 100 basis points. In turn, that claim of 100-basis-point underperformance is the foundation for the Department's claim that, unless it adopts its proposed rules, investors in front-end load funds will lose

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[20] *See* RIA at p. 7.

[21] *Id.*

[22] *Id.*

[23] Susan Christoffersen, Richard Evans, and David Musto. "What Do Consumers' Fund Flows Maximize? Evidence from Their Broker's Incentives." *Journal of Finance* 68 (2013): 201-235. Christoffersen *et al.* claims to find that funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns than funds in the same Morningstar category. As with the other papers that the RIA cites, Christoffersen *et al.* do not measure or test whether these returns were lower than what investors would have received had they used a fiduciary adviser. Nor does the paper provide asset-weighted or sales-weighted returns to demonstrate how investors who use broker-sold funds performed as a group relative to those using similar funds in their Morningstar category. Finally, the sample period used in the paper extends from 1993 to 2009, relying largely on fund performance that is 10 to 20 years old.

[24] *See* RIA Letter at pp. 13-15.

$500 billion to $1 trillion in foregone returns during the next 20 years.[25] In fact, that claim is mere hyperbole, unsupportable by the data.

B. Investors' Actual Experience with Broker-sold Funds Contradicts the Department's Claims

The RIA does not contain any independent analysis of fund performance to support its claim of underperformance arising from investors' use of brokers that are not fiduciaries. We are not aware of any data available to measure directly how investors using brokers fare relative to investors using fiduciaries. Instead, given the shortcomings of the academic literature and flawed analysis the RIA relies on to support its claims of "underperformance," we undertook our own analysis of the recent actual performance of fund investors in broker-sold funds. As discussed below, our findings contradict the RIA's "underperformance" claims. We find that front-end load funds outperform the average fund with the same investment objective and only slightly underperform the sales- or asset-weighted returns on retail no-load funds.

1. Contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category.

To measure the experience of investors in broker-sold share classes, we use gross sales and assets of front-end load share classes from 2007 through 2013. The reason for focusing on the more recent time period is that the mutual fund market has changed significantly in the past twenty years, as we discussed above.[26] We then calculate fund returns, net of fund fees, based on Morningstar data.[27]

Using sales data from 2007 through 2013, we find that front-end load share classes tended to perform better than their Morningstar category average, and that investors concentrated their purchases (*i.e.,* fund sales) in better performing front-end load share classes. As Illustration 2 shows, weighting each share class's relative return by its previous year's gross sales as reported by funds to the ICI, the sales-weighted one-year relative return was 27 basis points. In other words, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. The average front-end load share class outperformed its Morningstar category average by 13 basis points during this period. The fact that the sales-weighted average exceeds

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[25] *Id.*

[26] Our analysis begins in 2007 because the shift to direct competition between broker-sold and direct-sold funds continued to occur in the mid-2000s. The analysis ends with funds' performance in 2014, the last full year of performance data.

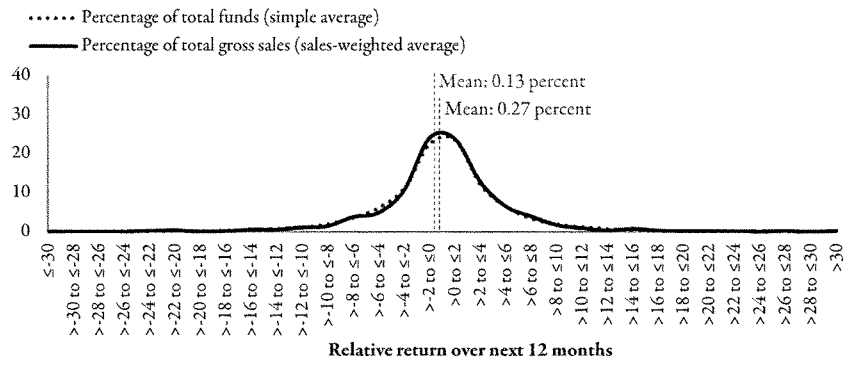
[27] The ICI maintains a survivorship-bias free database of Morningstar data.

the simple average suggests that brokers tended to guide their clients to funds that subsequently slightly outperformed, not underperformed, the average front-end load share class.

Illustration 2

Annual Returns on Front-End Load Share Classes Relative to Their Morningstar Category Returns

2008–2014



Note: The relative return is calculated by taking the one-year return of a share class of a fund (net of expenses) less the one-year return on the share class's Morningstar category (net of expenses) for each year from 2008 through 2014. The results are then placed into bins and plotted by summing each share class's gross sales in each prior year as a percentage of gross sales over the entire 2007–2013 period. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

Some academic studies, seek to measure the outcomes of investors using brokers by comparing returns on broker-sold funds with no-load or direct-sold funds,[28] under the assumption that no-load or direct-sold funds capture how investors using broker-sold funds might perform if their brokers could use funds outside the broker-sold universe.

On a three-year relative return, the difference in returns between front-end load and retail no-load share classes is 27 basis points.[29] Some of this difference is accounted for by 12b-1 fees, which compensate brokers and their firms for the services that they provide to their clients. Investors would

[28] Direct-sold funds are funds sold *directly* by a fund company, in contrast to funds that are sold *indirectly* by intermediaries to a fund company – like brokers.

[29] *See* RIA Letter, Figure 4 and accompanying text, at pp. 20-21.

have to pay for services whether they used a broker or a financial adviser that was an ERISA fiduciary. When 12b-1 fees are added back to measure the performance before compensating the brokers and their firms, the difference in returns between front-end load funds and retail no-load funds drops to 6 basis points on a sales-weighted average and 7 basis points on an asset-weighted average. These differences are less than one-tenth the 100 basis point "underperformance" that the RIA asserts.[30]

Illustration 3

Three-Year Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns

Percent; selected periods

	ICI sales-weighted average		Morningstar asset-weighted average	
Year	Front-end load	Retail no-load	Front-end load	Retail no-load
2007	-0.09	-0.03	0.20	0.45
2008	0.07	0.56	0.07	0.56
2009	0.14	0.33	0.23	0.55
2010	0.39	0.62	0.62	0.77
2011	0.41	0.70	0.67	0.88
Average:				
2007–2011	0.17	0.44	0.37	0.65
Memo: Sales- and asset-weighted 12b-1 fee over given period				
2007–2011	0.23	0.03	0.23	0.02

Note: The relative return is calculated by taking the three-year return of a share class of a fund (net of expenses) less the three-year return on the share class's Morningstar category (net of expenses) for each year from 2010 through 2014. These relative returns are then matched to their three-year prior gross sales or assets. For example, the 2007 sales-weighted averages report the three-year relative return for the period 2008–2010 weighted by gross sales in 2007. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

2. The data also show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads.

There is further evidence that brokers do not systematically steer their clients to poor-performing funds with higher loads or fees. We examined data from Strategic Insight Simfund, which

[30] Using a three-year relative return introduces a small survivorship bias because some share classes are in the one-year returns but not in the three-year returns. On average, 1.6 percent of the front-end load sales in each year have no three-year return and 2.0 percent of retail no-load sales, on average, have no three-year return.

contains N-SAR data from 2010 to 2013 showing loads paid to brokers, measured as a percentage of total fund sales subject to a load.[31] If brokers are skewing investors to funds that pay the brokers higher loads, then we should expect sales-weighted average loads to be higher than the simple average load paid. Instead, for each fund investment group, the sales-weighted average load paid to brokers is less than the simple average load paid. These data on loads contradict the notion that brokers are systematically steering their clients to funds that pay above-average loads.

3. Sales of front-end load share classes are skewed toward those with below-average expense ratios – further contradicting the notion that brokers systemically are not acting in the best interests of their clients.

Fund expense data also show strong market forces at work driving investors to funds with below-average expenses. Sales of front-end load share classes are skewed to those with below-average expense ratios, measured as either the total expense ratio (which includes the 12b-1 fee) or the fund expenses used to operate the fund (the total expense ratio minus the 12b-1 fee). Sales-weighted and asset-weighted expense ratios for front-end load share classes are below the simple average total expense ratios or operating expense ratios for front-end load share classes.[32]

Investors in front-end load share classes are paying fund expenses that are in line with retail no-load share classes. Sales-weighted and asset-weighted expense ratios are higher for front-end load share classes than for retail no-load share classes, but a large portion of the difference is that expenses of front-end load share classes include 12b-1 fees used to pay brokers or intermediaries for their services. Focusing on the expenses used to operate the fund ("operating expense ratios"), investors in front-end load share classes generally are paying operating expenses near what investors in retail no-load share classes are paying. And the asset-weighted and sales-weighted operating expense ratios for front-end load share classes are below the simple average operating expenses charged by the average retail no-load share class in all but one case (the sales-weighted taxable bond). These figures undermine the Department's contention that investors "pay insufficient attention to expenses."[33]

In conclusion, our analysis shows that the experience of investors in front-end load funds since 2007 is dramatically different from the RIA's description of the experience of investors using front-end load funds. We find no evidence to support the RIA's assertion that there is a "substantial failure of the market."[34] Furthermore, as we discuss below, the RIA overstates the benefits of the Department's proposal by failing to consider all of its costs. Under the proposal's current design, investors with small

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[31] *See* RIA Letter, Figure 6 and accompanying text, at pp. 22-23.

[32] *See* RIA Letter, Figure 7 and accompanying text, at pp. 23-25.

[33] *See* RIA at p. 97.

[34] *See* RIA at pp. 3, 7, and 211.

balances could potentially pay more for their services from financial advisers, be shut out of the advice market, or be faced with much larger switching costs. In fact, the net impact of the fiduciary proposal as it is currently designed could be negative for many IRA investors.

C. The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts

The Department's evaluation of the impact of the fiduciary proposal focuses solely on the costs of advice and assistance paid through a fund—pursuant to an up-front sales charge and 12b-1 fees, for example. But the Department fails to consider how these costs compare to the costs that investors incur when they pay a financial adviser directly for advice (for example, using an asset-based fee that an investor pays directly to a financial adviser) rather than paying through a fund with a front-end load or a 12b-1 fee. In doing so, the Department exaggerates the benefits from lower loads resulting from its proposal and ignores possible costs that investors could incur if they move to fee-based advice.

The RIA calculates that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. Most front-end load funds have a 12b-1 fee which also is used to compensate the broker and the brokerage firm for their services. The average 12b-1 fee for front-load funds, on an asset-weighted basis, is about 24 basis points. Adding together both the annualized load costs of 26 to 28 basis points and the 12b-1 fees, the total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year.

The Department predicts that its BIC Exemption will induce brokers to reduce loads substantially over 20 years.[35] As the Institute points out in its comment letters, the BIC Exemption is unworkable; even if it could work, it would impose prohibitive costs on brokers. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as its increased exposure to liability, are likely to seek to move many of their clients to fee-based accounts. Such accounts, however, require much greater level of time and engagement through frequent rebalancing of investors' accounts a level of service that is unnecessary for an investor with a modest balance who is typically better off as a buy-and-hold investor. This additional ongoing engagement results in higher and ongoing expense for the investor.

A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.[36] As detailed in ICI's comment letter to the Department of Labor, it is reasonable to assume that IRA investors with balances will migrate to fee-based advisers and thus pay more. Even allowing

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[35] *See* RIA at p. 113.

[36] *See* Cerulli Associates, Inc., *Cerulli Report RIA [Registered Investment Advisor] Marketplace 2014* at 20. The average asset-based fee includes high-net worth accounts, which typically are charged lower asset-based fees. Accounts of average or smaller size may pay higher fees.

for an increase in performance equal to that of investors in no-load funds relative to broker-sold funds over the past few years, if all IRA investors in broker-sold funds with balances of at least $100,000 migrate to fee-based accounts, we estimate that they will pay higher fees and thus earn lower returns totaling $47 billion over 10 years.

D. The RIA Fails to Account for the Societal Harm of Investors Losing Access to Advice and Guidance

In its estimates of the cost of its proposed rule, the Department focuses only on administrative or compliance costs. It does not measure any harm that can occur if it adopts the proposed rule—including the risk that at least some retirement savers could lose access to advice and information they currently rely on to meet their savings goals.

If the problems with the proposed fiduciary definition and the BIC Exemption are not addressed, we expect that significant numbers of investors should be expected to lose access to the guidance, products, and services that they currently receive from brokers. Financial advisers, regardless of their standard of care, are unlikely to work in an environment of greater costs, limitations, and exposures to liability for less compensation. Indeed, many broker-dealers are likely to exit the market for retirement advice under the proposed rule. The Department thus ignores the impact of its proposed rule on the quality and appropriateness of investment choices that retirement savers must make.

ICI research finds that IRA investors rely on financial professionals to assist with rollovers, creating a retirement strategy, and determining withdrawal amounts.[37] We also find a positive correlation between investors' use of financial professionals and investors' willingness to take financial risk.[38] Indeed, in its justification of an earlier rule change, the Department said that retirement investors who do not receive investment advice are twice as likely to make poor investment choices as those who do receive that advice.[39] The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

Retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. But as we have already established, the cost of investing through those accounts can be greater—not less—than the cost of investing with brokers.

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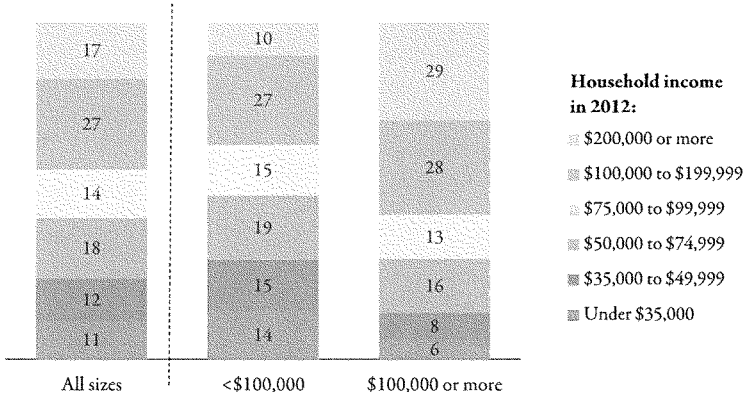
[37] *See* Sarah Holden and Daniel Schrass. 2015. "The Role of IRAs in U.S. Households' Saving for Retirement, 2014." *ICI Research Perspective* 21, no. 1 (January), available at www.ici.org/pdf/per21-01.pdf.

[38] *See* Daniel Schrass, "Ownership of Mutual Funds Through Investment Professionals, 2012," *ICI Research Perspective* 19, no. 2 (February 2013), available at www.ici.org/pdf/per19-02.pdf

[39] *See* Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

Moreover, fee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements. Currently, fee-based advisers often require minimum account balances of $100,000 because, even with a 1 percent fee, accounts with fewer assets generate too little income to make the provision of ongoing advice profitable. Significantly, 75 percent of all IRA accounts in The IRA Investor Database have less than $100,000 in them. And low- and middle-income households are more likely to have IRA balances below $100,000, as shown in Illustration 4.

Illustration 4
Households Owning Traditional and/or Roth IRAs
Percentage by household income and household IRA balances



Size of household's traditional and Roth IRA balance in 2013

Note: In 2013, 65 percent of households with traditional or Roth IRAs had balances of less than $100,000 and 35 percent had balances of $100,000 or more.
Source: ICI Tabulation of Federal Reserve Board 2013 Survey of Consumer Finances

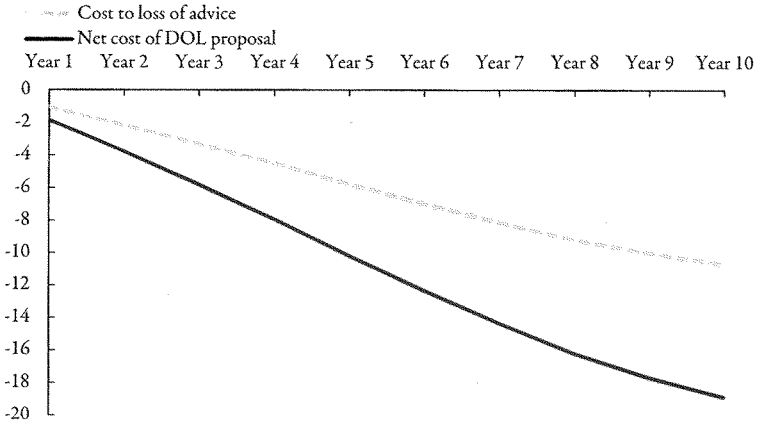
Other market participants may seek to overcome the proposed rule's barriers and find ways to serve retirement savers who now rely on broker-dealers. It is entirely foreseeable, however, that many IRA investors would no longer be able to obtain advice under the proposed rule. If these investors, over time, lose access to advice and service, their accounts are likely to earn lower returns in the future. These lower returns could occur, for example, through poor asset allocation decisions, poorly timed investment decisions, penalties for early withdrawals, or incorrectly calculated required minimum distributions. Even if these individuals no longer have to pay for services, the net loss on their accounts would have a negative impact.

Assuming that investors with less than $100,000 in IRA balances no longer have access to advice because the BIC Exemption is not workable, then over time these investors are likely to experience lower returns because of poor asset allocation and market timing, or because they incurred tax penalties by taking early withdrawals. Factoring in the lower performance for these investors, and adding to the additional costs for the other 81 percent of IRA assets that would shift to fee-based accounts, it is possible that the net loss from the proposal, if adopted, could impose annual losses to investors mounting to nearly $19 billion a year within 10 years (Illustration 5).

Illustration 5

Annual Effect on Investors If They Lose Access to Financial Advice

Billions of dollars a year



Source: Investment Company Institute

The losses that investors would likely incur under the Department's proposal stand in stark contrast to the benefits that the CEA and the Department claim. The reason that the CEA and the Department can claim that the proposal would have a net benefit to investors is that their analysis shares several common errors, including: (a) overestimate of the "underperformance" of broker-sold funds; (b) misapplication of the academic research underlying the estimates; (c) failure to acknowledge the added costs borne by investors forced to move from commission-based to fee-based accounts; and (d) failure to acknowledge lost returns suffered by investors with small accounts who forego advice altogether due to loss of the commission-based option.

Correcting for these errors and omissions, we find significant net costs to investors, whether calculated on an annual basis using the CEA's methods or for the first 10 years after implementation by the Department's methods. Indeed, correcting for the Department's many errors and omissions, we

find that the Department's proposal, if adopted, will result in net losses to investors of $109 billion over 10 years.

We are, of course, unable to quantify other significant potential costs resulting from the Department's proposed rules. As we discuss above and in our comment letters, the consequence of an expansive and ambiguous fiduciary definition combined with an unworkable BIC Exemption will be that investors —particularly investors with small account balances— will find significant barriers for seeking out advice and assistance, even outside the broker market. Increasing information barriers and transaction costs certainly would reduce the ability of IRA investors, like my son, to move from one adviser to another or from one fund provider to another, further harming investors.

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On behalf of the Institute and all of our members, thank you for the opportunity to offer this statement. I look forward to answering any questions of the Subcommittees.

RAYMOND JAMES®

Preserving Retirement Security and Investment Choices for All Americans – September 10, 2015

Testimony submitted by Scott Stolz

I would like to first thank the Committee for the opportunity to testify here today. As mentioned, I am Scott Stolz, Senior Vice President for Private Client Group Investment Products at Raymond James. On behalf of Raymond James and its 6,500 advisors and 10,000 employees that work hard every day to take care of the financial needs of our 1 million clients, I want to express my appreciation for giving me the opportunity to share our views on this very important topic. From our home base in St. Petersburg, Florida, Raymond James has grown to a national firm based mainly on a retail business model that serves individual investors. Our firm's core principle is Service First. We believe that if we take care of the client, everything else will take care of itself. This emphasis on taking care of the client, combined with our focus on long term results rather than the next quarterly earnings cycle, has helped us achieve 110 consecutive quarters of profitability – a string that I'm proud to say was not broken during the financial crises. It is with this in mind, that I want to say first and foremost that we understand the impassioned and serious debate that surrounds this issue.

Most of those in favor of the Department of Labor's proposal want to frame the debate solely on whether or not a financial advisor should put the client's best interest before their own. After all, who could possibly argue with that? Rather the debate is really about the road we take to get there. Once one fully understands the 600 page proposal that the Department has put forth to achieve this mutually agreed upon goal, the only possible conclusion is that the rule as written is overly complex, would be incredibly expensive to implement, and would expose the hundreds of thousands of trusted and well-meaning financial advisors to unfair legal liability.

On more than one occasion, Secretary Perez has cited the case of the Toffels as an example of why this rule is needed. The Toffels' had accumulated much of their life savings in various Vanguard mutual funds. Their bank recommended that they cash out the mutual funds and use $650,000 of the proceeds to purchase a "very complex" variable annuity. This recommendation has been criticized for being too costly. According to Secretary Perez, this conflicted advice most certainly caused the advisor to put his interests before that of the Toffel's. Please don't misunderstand; I'm not taking a position on the quality of the advice the Toffels received. I simply do not have enough facts to make that determination. Nor, might I add, does the Department of Labor. But what I do know is that the Toffel's case can be used as an example of the flaws of the current proposal.

According to a New York Times article on this case,[1] the Toffels told the bank that they needed an investment that provided a lifetime income. A variable annuity with the level of fees documented on this case would have come with a lifetime income benefit that paid a specific amount of income for life, even if the stock market caused the Toffels' account value to fall – a possibility that is still very much on the minds of all retirees. In addition, that variable annuity would have come with a guaranteed death benefit that would guarantee that Mrs. Toffel would receive much, if not all of the original $650,000 investment upon Mr. Toffel's death – again, even if markets had caused their account value to fall in value. The Vanguard mutual funds – while a much cheaper solution – would not have provided either of these guarantees. In addition, since the advisor understood the liquidity limitations of the annuity, he had them put $200,000 into money market accounts – an important fact left out of the DOL's version of the events.

Unfortunately, the Toffels' situation changed when Mr. Toffel's health deteriorated. Not surprisingly, financial flexibility suddenly became more important than a secure, lifetime income. It seems obvious to me that the annuity recommendation didn't work out not because it was not in the Toffel's best interest, but because their circumstances significantly changed. Yet, here we are not only second guessing the recommendation, but condemning it and labeling it a "tragic" story, to use the Secretary's words. And this is exactly what will play out time and time again if the DOL proposal is adopted as is. The complexity, ambiguity and legal requirements of the rule will insure that well-meaning advisors that work hard to put their client's best interests first will be subject to Monday morning quarterbacking. Faced with this potential, advisors will make investment recommendations based in part on how they can best limit their future liability. It is inevitable therefore that they will move to one size fits all pricing model so that they can avoid any possibility of being accused of making a recommendation based on how they are compensated. Under such a model, many will either pay more than they do today or will receive no advice at all. This will be particularly true for the smaller investors – the very investors the DOL is trying to protect.

Current securities laws and regulatory practices protect advisors from unwarranted "Monday morning quarterback" claims to some degree. Unfortunately, the Department's proposal will strip these protections and open a Pandora's Box of litigation based on investment outcomes that can never be predicted with certainty by even the best intentioned advisor.

We stand ready to continue to work with the DOL to craft a final rule. And we believe that if the DOL adopts the changes we outlined in our comment letter, they can indeed finalize a rule that accomplishes their goals with minimal disruptions to the current financial system. However, since they have indicated that there will not be a re-proposed rule, we are understandably concerned that the final rule will be no more workable than the current proposed rule. In addition, we believe that the SEC's deep industry knowledge puts them in a better position to craft a workable rule. For these reasons, we support the Wagner bill.

In closing, I want to emphasize that Raymond James has long been a supporter of a common fiduciary standard. Long before the DOL first proposed a rule, we instituted a client bill of rights that is given to every client of Raymond James. Amongst these rights is the right to expect recommendations based solely upon the client's unique needs and goals, as well as the right to know all costs and commissions associated with the recommendation. We just do not believe a rule hundreds of pages in length is necessary to achieve this goal. I would like to thank the committee for its time and I would be happy to answer any questions you may have.

[1] "Before the Advice, Check Out the Adviser", by Tara Siegel Bernard, New York Times, Oct. 10, 2014

Caleb Callahan
Senior Vice President and Chief Marketing Officer, ValMark Securities, Inc.
On behalf of the Association for Advanced Life Underwriting (AALU)

Hearing on Preserving Retirement Security and Investment Choices for All Americans

Before the Subcommittees on Oversight & Investigations and Capital Markets and Government Sponsored Enterprises of the House Financial Services Committee

Additional Comments for the Record

September 24, 2015

I am submitting the following analysis for the record, on behalf of AALU, to clarify issues that were discussed during the "Hearing on Preserving Retirement Security and Investment Choices for All Americans" before the Subcommittees on Oversight & Investigations and Capital Markets & Government Sponsored Enterprises of the House Financial Services Committee.

Near the end of this hearing, the Honorable Al Green (D-TX) restated a question that was posed by Professor Bullard during his testimony—should brokers be allowed to sell equity mutual funds that pay them twice as much as bond mutual funds—and asked the panel for a response. However, Congressman Green restricted panelists to answering yes or no, and with the hearing ending shortly thereafter I feel it is important to submit these additional comments to ensure that the Financial Services Committee has a proper perspective of marketplace reality.

Professor Bullard's analysis of the market is incomplete, and does not take into account current market conditions and trends.

- Professor Bullard's analysis focuses solely on mutual funds, which represent only one type of asset available to retirement savers. Even if this analysis were accurate, the new regulatory regime being proposed by the DOL would apply to every investment available to retirement savers, not just mutual funds. If there is a problem with the sale of mutual funds in the marketplace, it would seem that more targeted regulatory steps would be appropriate.

- Professor Bullard focuses on only a narrow set of mutual funds that are available in the marketplace—primarily load mutual funds. While this analysis may have been more relevant in the past, load funds are declining in terms of market share. The amount of savings in no-load mutual funds is over 3 times greater than the amount in load mutual funds. Further, in 2014, load mutual funds saw a net outflow of $175 billion, while no-load mutual funds saw a net inflow of $341 billion over that same period.[i] In other words, the market is already trending steadily away from load funds, without the imposition of a complex regulatory structure.

- Within the category of load mutual funds, Professor Bullard uses extreme examples in his analysis. He implies that the sales load paid for an equity fund is frequently twice as much as the sales load for a bond fund. However, the maximum difference in sales loads between equity and bond funds is 5.4% v 3.8%, while the average difference is 0.9% v 0.7%—nowhere near twice as much.[ii]

- Equity funds do exist in the marketplace that are cheaper than bond funds—for example, a no-load equity fund will always pay less than a load bond fund. There are a variety of mutual fund options available in the marketplace, and the ability of advisors and savers to choose what product is best for them has driven costs down—just like in other industries. The fact is that average compensation is far less in my firm than is implied by Professor Bullard's testimony.

- Based on my experience working with advisors that provide both fee-based and commission-based solutions every day, empowering customers with concise, actionable data will help average retirement savers achieve their goals, while this complex DOL proposal will have the opposite effect. If there are gaps that need to be addressed to improve consumer understanding, they should be addressed specifically. Instead, the DOL has taken extreme scenarios and then proposed a solution that applies to the entire retirement savings marketplace. A more practical and effective solution is to provide retirement savers with tools that will allow them to make informed choices about what is best for them considering their goals and interests—not what regulators say is in their best interest.

It is essential for policymakers and regulators to understand current market conditions for retirement savers, so that problems can be identified and specific solutions can be provided to address identified concerns. I appreciate the opportunity to provide committee members with a more complete picture of marketplace reality.

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[i] "2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Institute," Investment Company Institute, 2015. Accessed September 22, 2015. Available at: http://www.icifactbook.org/fb_letter.html.

[ii] Ibid.

ACLI
Financial Security...for Life.

Statement for the Record
House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises
Subcommittee on Oversight and Investigations
Hearing entitled "Preserving Retirement Security and Investment Choices for All Americans"

September 10, 2015

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record regarding the Department of Labor's (DOL) fiduciary rulemaking efforts. We thank Subcommittee Chairmen Scott Garrett and Sean Duffy and Ranking Members Carolyn Maloney and Al Green for holding this important hearing.

On behalf of the U.S. life insurance industry, we share the President's view that "retirement advisers should put the best interests of their clients above their own financial interests." In pursuit of this objective, however, the DOL has proposed a rule that will restrict activities that encourage low-to moderate-income Americans to save, stifle the formation of small business workplace benefit plans, and assist savers and retirees with securing guaranteed lifetime income throughout retirement.

The ACLI is a Washington, D.C.- based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities, long-term care, and disability income insurance, ACLI member companies offer insurance contracts and investment products and services to employment-based retirement plans (including defined benefit pension plans, 401(k), SIMPLE, SEP, 403(b), and 457(b) plans) and to individuals (through individual retirement accounts (IRAs) and annuities). Our members also are employer sponsors of retirement plans for their employees. As service and product providers, as well as employer sponsors, life insurers believe that savings for retirement, managing assets throughout retirement, and utilizing financial protection products are all critical to Americans' retirement income and financial security.

In September 2011, the DOL withdrew its first proposal to allow additional time for stakeholder input. Almost 200 House and Senate Members of Congress from both parties had urged the DOL to coordinate rulemaking with the Securities and Exchange Commission (SEC), provide a robust economic analysis, and provide workable prohibited transaction exemptions (PTEs). On April 20, the DOL proposed a new rule. Unfortunately, this new proposed rule goes even further than the initial proposal and is supported by an inadequate and flawed economic analysis. The new proposal severely narrows the scope of existing PTEs that have provided workers with access to a retirement savings account and invaluable retirement planning assistance. It proposes a new PTE that, absent significant changes, is not workable.

ACLI participated in the recent public hearings held by DOL on the proposal in August and reiterated these concerns. We plan to submit further comment before the close of the post-hearings public comment period.

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As leading providers in the small plan formation marketplace, life insurers are concerned that this proposal would impede the important policy goal of expanding small plan coverage. The proposal negatively impacts small plan formation by restricting sales activities that encourage small business owners (with 100 employees or fewer) to start, maintain, or improve their employee benefit plans. The DOL has limited the "sales exception" to exempt certain large plans, while impeding the sales of products and services to small businesses. Only 50 percent of workers employed in small businesses have access to retirement plans. Growing stress on government programs adds to the need for greater incentives for these small businesses to start and maintain retirement plans—not new barriers. The proposal also would place limits on education activities designed to assist savers with asset allocation and retirement planning. It treats educational materials as "recommendations" if they include references to specific investment products, investment alternatives, or distribution options – including annuities available under a plan or IRA.

Finally, the proposal would likely result in fewer commission-based services in the marketplace, leaving only fee-based and managed account services. Many low and middle income savers access education and information on ways to save for retirement and manage income in retirement through transactional, commission-based services. While fee-based and managed account services may make sense for upper income investors, such services may not make sense for buy and hold investors or those seeking information, education, or advice regarding guaranteed lifetime income through annuities. The DOL claims to provide for commission services through the proposal's "Best Interest Contract Exemption." Unfortunately, the exemption provides no clear path to compliance and would increase legal exposure, the potential for class action lawsuits, and excise taxes. This risk will add to the cost or, more likely, limit the availability of transactional commission-based services.

ACLI would like to thank the Members of the Committee for sharing their concerns about this proposal with the DOL and hope that we can all work together to ensure a durable rule that will not negatively impact individuals, plan formation or the current marketplace for investment education and advice. ACLI would also like to thank Representative Ann Wagner for her strong leadership in introducing H.R. 1090, the Retail Investor Protection Act. H.R. 1090 would facilitate coordination between the DOL and SEC and require appropriate economic analysis of the impact of a uniform standard of conduct. These are essential principles that would lead to better financial outcomes for families, savers, and retirees.

Life insurers are at the forefront of helping people save for retirements that may last decades and providing guaranteed lifetime income that supplements Social Security. Many people first learn of the benefits of annuities and other guaranteed lifetime income products from a life insurance agent or broker. Rollovers provide retirees a way to ensure guaranteed lifetime income with their retirement savings. Unfortunately, today, too few defined contribution plans offer retiring workers an annuity option. We appreciate and support the Administration's initiative that began in 2009 to highlight the importance of guaranteed lifetime income and address regulatory barriers that prevent greater access to lifetime income products for workers.

Let's continue to work together to expand access to plans, increase retirement savings and education, and facilitate guaranteed lifetime income. We urge the Administration and Congress to support the following principles to achieve a workable rule:

- A broadly applicable best interest standard based on the DOL's proposal, under which advice provided by financial professionals regarding investments, distributions, and rollovers would be required to be in the best interest of their ERISA plan and IRA customers.
- A workable prohibited transaction exemption under which financial professionals would be permitted to provide investment, distribution, and rollover assistance as long as the assistance is in their customer's best interest and the financial professional's financial incentives are fully disclosed.

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- A seller's exception based on the DOL's 2010 proposal under which financial professionals would not be considered fiduciaries if they make it clear that they are selling products or services and not advising an investor.
- A new rule that preserves the current-law rules regarding investment education and, as under the current DOL proposal, extends the education rules to education provided to plan sponsors and IRA owners, and to education regarding distributions and rollovers. Unlike the 2010 DOL proposal, the 2015 DOL proposal would substantially restrict the types of investment education that can be provided without triggering potential fiduciary liability.

We hope to be a partner to the Administration and Congress as we all work toward a common goal—providing financial security and peace of mind for American families.

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Testimony Submitted for the Record

Statement of Grover Norquist, President of Americans for Tax Reform

Hearing on Preserving Retirement Security and
Investment Choices for All Americans

Before the Subcommittees on Oversight & Investigations and Capital Markets and
Government Sponsored Enterprises of the House Financial Services Committee

September 10, 2015

Misters Chairmen and Ranking Members, thank you for allowing me to submit testimony for the record in this matter.

It should come as no surprise that President Obama is no fan of tax-neutral, defined contribution savings plans.

After all, this is the same president who secretly tried to destroy the 529 college savings plan for the middle class back in January 2015. His budget routinely calls for a lifetime accumulation cap on 401(k) plans.

Now President Obama's own Department of Labor is pushing a complex new regulation that will have the effect of shutting out newer investors and younger investors from the world of IRAs.

Among other huge problems, this "fiduciary rule" will result in the following:

IRA companies won't be able to even talk to potential investors. Under the rule, if a brokerage company wanted to pitch a Traditional IRA or a Roth IRA to a new investor, they first have to get the prospective investor to sign a bunch of cumbersome paperwork and waivers. No one is going to want to do that, and investors will simply not take the time and effort.

IRA companies won't be able to recommend specific investments for your IRA. Even if you're already a customer at a brokerage firm, the company won't be able to make specific investment recommendations within your IRA. Suppose you don't know which mutual fund to buy from the thousands out there? You're out of luck and you're on your own. After all, robots and search engines are always an option.

You can't get advice on rolling over your 401(k) to an IRA. One of the most intimidating things people do--for fear of screwing it up and wrecking years of retirement and tax planning--is rolling their old 401(k) into an IRA. Thankfully, the IRA companies have experts who can help guide you through the process without a hitch. Until now. These regulations prevent any advice related to IRA rollover. Again, you're on your own.

Small business employees and companies can't get any expert advice on investing. IRA companies also often help smaller firms (fewer than 100 employees) set up 401(k)s, SIMPLEs, and other workplace defined contribution retirement plans. Under the regulation, neither the employer nor the employees could get advice on how to invest in these plans. Again, you're sensing a theme here--you're on your own.

As a result of these regulations, several bad outcomes will occur for taxpayers:

The number of people wanting to bother with IRAs will go down. We've seen this before. After the Tax Reform Act of 1986, IRAs were curtailed. IRA contributions and participation plummeted. If you take away help from people in managing their IRAs, they will either not save at all, or will save in taxable brokerage accounts where they face capital gains and dividends taxes.

Capital gain and dividend taxes today run as high as 23.8 percent on the federal side alone. Compare that, say, to a Roth IRA which never faces any tax on earnings if used for retirement. The resulting tax hit will result in high effective tax rates on the savings, and several years of delayed retirement, all else being equal.

Smaller and younger investors will be shut out. These regulations seem targeted at the younger and smaller end of the IRA investment world. That's because the regulations essentially force brokerages to migrate IRA products to a percentage-of-assets payment system, as opposed to a system of per-trade commissions. Most financial advisors, however, have a minimum amount of assets (usually at least $50,000 or $100,000) before they will be compensated this way--there's just not the economy of scale.

Smaller investors will face a horrible choice--pay higher fees in order to keep essential financial advice, or be shut out and on their own.

With 58 percent of small investors seeking financial advice today, there are millions who stand to lose a key source of expertise. Up to 7 million IRAs would not qualify for investment advice under these regulations.

As a result, recent college graduates and workers on the lower end of the earnings spectrum will find themselves shut out from investment advice. These are precisely the people who need it the most.

All of us will pay more. The IRA industry estimates that these regulations will cost $5 billion to implement, and $1 billion annually to maintain.

Companies don't pay taxes--people do. In this case, these deadweight regulatory costs of government will inevitably trickle down to higher investment fees for all of us.

Small businesses won't open retirement plans and employees won't invest with any confidence. Small businesses have a lot to worry about. For many, setting up a retirement plan is a luxury when they are trying to meet payroll month to month.

If they cannot get expert advice on these plans, small firms simply won't make them available. Even if they are set up, employees usually have no idea how to invest. Without expert advice, they are likely to either not participate or have their money sitting as cash.

Massive leakage from workplace retirement plans. Because people will no longer be able to get advice from IRA companies about how to do rollovers, the logical response will either be to keep 401(k) assets at their old employers (which can result in losing track of them), or more likely a cash-out. The latter results in taxes plus a ten percentage point penalty. More importantly, it can short-circuit a lifetime of retirement savings.

According to one study, between 300,000 and 400,000 fewer IRAs will be opened every year as a result of this regulation.

Why is President Obama and his Department of Labor doing this? Quite simply, they don't trust people to manage their own retirement savings. They would rather have most Americans rely on a combination of Social Security and union-dominated traditional pension plans. Not coincidentally, the latter group (unions) happens to be the biggest supporter of President Obama and his allies.

Just like the American people had to rise up in defense of their 529 college savings accounts, now is the time for them to rise up in defense of their IRAs, be they rollover IRAs, Traditional IRAs, spousal IRAs, or Roth IRAs. They need to rise up in defense of their workplace 401(k)s, SIMPLEs, and SEPs.

Building a nest egg for financial independence in retirement is a key cornerstone of the middle class American dream. President Obama's "fiduciary rule" aims to take it away. Don't let him.

CUNA
Credit Union National Association

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September 8, 2015

Chairman Sean Duffy
United States House of Representatives
1208 Longworth HOB
Washington, DC 20515

Ranking Member Al Green
United States House of Representatives
2347 Rayburn HOB
Washington, DC 20515

Dear Chairman Duffy and Ranking Member Green:

The Credit Union National Association (CUNA) appreciates that the Subcommittees on Oversight and Investigations and Capital Markets and Government Sponsored Enterprises are holding the hearing "Preserving Retirement Security and Investment Choices for All Americans" to consider the impact of the U.S. Department of Labor's (DOL) proposed rulemakings defining fiduciaries on retirement savers and the economy. CUNA represents America's credit unions and their more than 100 million members.

We urge Congress to consider how the DOL's proposed rule may affect credit union members' ability to participate in retirement and savings plans, and to consider whether this will have a detrimental impact on the ability of lower income working American families to invest. Additionally, we urge Congress to examine whether the DOL should more narrowly tailor the definition of "investment advice" to assure that credit union employees, who are only tangentially involved in providing investment services, are not included in the rule. Another concern for our members will be the fact that a credit union could be adversely affected by the rule if they share a dual employee with a third party. This is concerning because the compliance burdens for those who will qualify as ERISA fiduciaries are great, and small or medium size credit unions could be hesitant to engage in any activity that may sweep them into this expansive proposed rule, which could preclude their members from having access to investment products.

Discouraging Credit Unions to Offer Investment Services is Detrimental to Consumers

CUNA supports the goal of this rule to protect investors and encourage all advisors to act in the investor's best interest. Credit unions exist to serve their members, and inherent in the credit union movement is acting in a member's best interest. When offering investment services to their members, credit unions aim to help American families of all means receive information about saving for retirement and planning for their future. While many large investment firms seek high net-worth clients, credit unions seek to provide services to their members in all financial situations and make it easier for these individuals to map out financial plans.

Credit union members, and all consumers, deserve the best possible service when seeking information about retirement plans or Individual Retirement Account (IRA) distributions. However, it is important to have rules that encourage and promote retirement savings -- rather than potentially chill the ability of credit unions, or other financial institutions, to provide these products and services. The DOL's proposed rule is full of complexities and unworkable solutions, which is unclear if it will improve options for credit union members.

Congress Should Urge DOL to Rewrite Problematic Provisions Found in the Proposed Rule

CUNA encourages Congress to examine how the following could negatively affect consumers' access to retirement and other investment services:

- The overly broad consideration of what is considered "investment advice"
- The overly prescriptive requirements surrounding what is compensation
- The problematic "sellers carve-out"

Additionally, we ask Congress to consider the regulatory overlap that will affect credit unions if the rule is finalized in its current form. Federally chartered credits unions are supervised by the NCUA, and the Consumer Financial Protection Bureau if they have $10 billion or more in assets, and state-charted credit unions are regulated at the state level. Furthermore, the Financial Industry Regulatory Authority and U.S. Securities and Exchange Commission already require specific licenses and compliance with certain laws for registered brokers, insurance agents, and investment advisors in credit unions. Any additional oversight in this area is unnecessarily duplicative and could be burdensome to credit unions who are already facing a multitude of regulatory hurdles.

The responsibilities associated with being an ERISA fiduciary would require expensive and time-consuming compliance training for credit unions, during a time when credit unions are facing an unprecedented number of regulatory burdens. We believe it is important that credit unions are able to offer a full range of products and services to their members including products to help families save for retirement and other purposes. Any ambiguity and uncertainty in this area could cause financial institutions to exit or not join this market. We believe that it is important that credit union members continue to have access to investment services, and accordingly the DOL should more narrowly tailor its rule so that credit unions are not affected by the "Financial Product Safety Commission Act of 2015".

We urge Congress to act to reduce any unnecessary regulatory hurdles this rule would cause credit unions and their members, either intended or unintended. Thank you again for holding this hearing and examining the likely problematic consequences of the DOL's proposed rule. Attached for your review is CUNA's comment letter to the DOL that outlines our concerns in full.

Sincerely,

Jim Nussle
President & CEO

Statement Before the House Financial Services Subcommittees on Oversight and Investigations and Capital Markets and Government Sponsored Enterprises Hearing Entitled "Preserving Retirement Security and Investment Choices for All Americans."

September 10, 2015

The Independent Insurance Agents & Brokers of America (IIABA or Big "I") is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than a quarter of a million agents, brokers, and employees. IIABA represents agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property/casualty, life, health, employee benefit plans, and retirement products.

IIABA appreciates having the opportunity to comment on the regulatory oversight of broker-dealers and legislative proposals to improve investment and advisor oversight. A significant number of our members offer investment and securities-related insurance products and would be adversely affected by the establishment of a universal fiduciary standard of care as put forth by the Department of Labor's ("DOL") proposed new Fiduciary Regulation ("Proposed Regulation") and Prohibited Transaction Exemption Relief for Investment Advice Fiduciaries. While the establishment of an across-the-board fiduciary standard either by the DOL (in the retirement investment arena) or the SEC is a potential source of concern, the development of two competing and conflicting rules is especially troubling.

Such a significant revision to the current regulatory structure is unwarranted and the increased burdens on financial providers and adverse consequences for consumers certainly outweigh any potential accompanying benefits. The proposed regulation does not reflect the reality of the size and types of retirement savings plans – both qualified and non-qualified available in the marketplace. Industry data indicates that employees of smaller sized employers are not covered by employer provided retirement plans and the proposed regulation is counterproductive to accomplishing this important objective due to the creation of a new classification – "Investment Advice Fiduciary." Further, the primary retirement programs – SEPs and SIMPLE IRAs – were created to serve this underserved market, yet advisors to these plans will incur added costs and complexities in order to adhere to the proposed regulation. The asset size of these plans and the need for business owners to have a resource to help with the implementation of these plans are quite different than the large qualified plan marketplace. The indiscriminate and wholesale application of this proposed standard has not been adequately defended and justified by its proponents in addressing the realities of the marketplace.

Imposing such a standard would force broker-dealers and their registered representatives to recommend the absolute "best" option to their customers, but identifying the ideal product among many different alternatives is not as simplistic, straightforward, and clear-cut as some mistakenly believe. Any such determination is inherently subjective (especially given the wide range of variables that can be considered in making such a determination) and one person's conclusion concerning the best available option for a particular consumer will naturally differ from others. In addition, the preferred option at the time a recommendation is offered may not seem so appealing or attractive in hindsight if it does not meet anticipated expectations or is outperformed over time by a competing product.

As a result, altering the existing standard will also reduce the universe of qualified professionals willing to offer knowledgeable assistance and investment services (often at no direct expense to the buyer). This government-imposed weakening of marketplace competition will ultimately harm consumers. Many broker-dealers and registered representatives, including the main street businesses represented by IIABA, will simply cease their securities-related operations given the uncertainty associated with such an amorphous and subjective standard, higher compliance and insurance costs, and well-founded fears about increased liability exposure. A sizable number of IIABA's members are able to review and service the investment, insurance, and other financial needs of their customers on a holistic basis today, but a change in the standard of care will force many to narrow their emphasis and instead operate only in limited niches or sector-specific silos. With fewer advisers serving the financial needs of the general public, far fewer consumers will have the opportunity to access the variety of financial products

and quality of personalized financial assistance available to other more affluent Americans. Many middle class Americans – especially those unwilling or unable to pay upfront fees for guidance – will effectively lose access to competent financial guidance and certain investment products and services.

The Big "I" supports H.R. 1090 "The Retail Investor Protection Act," because the legislation addresses two major issues cited in this testimony. First, the bill prevents the DOL from issuing any regulation that redefines who is considered to be a fiduciary until after the SEC issues its final rule concerning standards of care. This will help eliminate the possibility that separate entities within the federal government will produce conflicting and unworkable regulatory standards for broker dealers. Second, the measure would establish several due process requirements that must be satisfied before the SEC may act. Specifically, the bill would require that the SEC investigate whether retail investors are actually being harmed by the different standards of conduct that apply to advisors and broker-dealers today, whether the adoption of an indiscriminate uniform fiduciary standard would adversely affect consumer access to investment professionals, and whether there are effective alternatives that the SEC should implement. The type of common-sense study and analysis required by the bill should be a natural and obvious prerequisite to any action in this area, and we strongly urge you to take swift action on this important legislation.

Broker-dealers and registered representatives already adhere to a rigorous and strictly-enforced standard of care and may only offer or recommend products that are suitable for a customer based on that person's needs, objectives, and financial situation. Before a recommendation can be made, a financial provider must acquire and analyze important information about the client and determine which investments are suitable in light of those facts. Recommendations concerning certain products trigger even greater regulatory requirements under current law, and transactions involving the purchase or exchange of deferred variable annuities, for example, highlight how precise and prescriptive these existing mandates can be. A strong regulatory regime with meaningful market conduct, supervisory, record-keeping, and other mandates is already in place, and appropriate and potent remedies exist for those who are the victims of improper or unlawful acts. Anomalies and examples of improper marketplace behavior will occur in rare instances, but strong regulation and enforcement of existing requirements is the proper and more effective response. Altering the standard of care is not a panacea that will eliminate bad actors and bad behavior, and it is important to remember that some of the most noteworthy and notorious financial crimes in U.S. history have been committed by registered investment advisers (including Bernard Madoff) who were required to adhere to the same standard of care that the Proposed

Regulation attempts to implement for advisors without regard to the marketplace they serve.

We support the Retail Investor Protection Act because the legislation creates a number of important checks and balances for the rulemaking process to ensure that consumers are not harmed by the expansion of the fiduciary duty.

Insured Retirement Institute

Testimony of Catherine Weatherford

President and CEO, Insured Retirement Institute

Hearing on "Preserving Retirement Security and Investment Choices for All Americans"

Subcommittees on Capital Markets & Government Sponsored Enterprises and Oversight & Investigations

U.S. House of Representatives

September 10, 2015

On behalf of the Insured Retirement Institute (IRI), I welcome the opportunity to submit written testimony to the members of the Subcommittees on Oversight and Investigations and Capital Markets and Government Sponsored Enterprises for the hearing entitled "Preserving Retirement Security and Investment Choices for All Americans". We appreciate the subcommittees' examining the U.S. Department of Labor's (DOL's) proposed "Fiduciary Rule" and the consequences for retail investors, retirement savers and our nation's economy, in addition to H.R. 1090, the Retail Investor Protection Act.

IRI is the only national trade association that represents the entire supply chain of the retirement income industry. We have more than 500 member companies, including major life insurance companies, broker-dealers, banks, and asset management companies. Our member companies account for more than 95% of annuity assets in the United States, include the top 10 distributors of annuities ranked by assets under management, and are represented by more than 150,000 financial professionals serving over 22.5 million households in communities across the country. IRI and its members therefore represent not only their own views, but also those of their clients on Main Streets across America. As such, IRI is uniquely positioned to comment on the implications of the proposal for manufacturers, distributors and consumers of annuity products that provide guaranteed lifetime income.

We are concerned the DOL's fiduciary rule proposal will have unintended consequences that jeopardize and limit consumers' choices and access to beneficial financial products such as annuities. As Americans are living longer and facing greater obstacles to saving for retirement, the role of guaranteed investment products in helping consumers achieve a financially secure retirement has never been more important. Annuities are the only financial products that guarantee lifetime income throughout retirement. When you consider the retirement reality in America – defined by the unsure footing of Social Security, the near disappearance of pension plans and the record losses in 401(k) plans – it is clear that Americans planning for retirement must have a second form of guaranteed retirement income.

IRI submitted a detailed comment letter to constructively help DOL revise its proposal to preserve consumers' access to guaranteed lifetime income products and the professional advice needed to understand, purchase, and manage those products. To help DOL achieve its consumer-protection objectives without the negative unintended consequences of the current proposal, IRI and our members identified the following core principles DOL should follow when revising its proposal:

1. Financial professionals should be held to a best interest standard when recommending investments to retirement savers.

2. Consumers are entitled to freedom of access to retirement income guarantees.

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3. In the post-defined benefit plan era, the availability of guaranteed retirement income through IRA rollovers meets a critical consumer need.

4. Rules for annuity products must be specifically crafted to account for their guaranteed lifetime income features.

5. Competitive annuity markets serve consumer interests.

6. Consumers have a right to choose their preferred source of retirement advice, including the option to work with advice providers who are experts on proprietary products, and how their advice provider is compensated.

7. The Administration's public policy position in favor of access to and utilization of guaranteed lifetime income products should be advanced.

IRI believes a standard established on these principles will maintain a competitive annuity market that serves consumer interests while preserving consumers' access to and utilization of guaranteed lifetime income products.

In addition, IRI supports Congresswoman Wagner's Retail Investor Protection Act, which would ensure meaningful regulatory coordination and consultation as part of the DOL rulemaking process by requiring DOL to delay its rulemaking effort until the Securities and Exchange Commission (SEC) issues a final rule establishing a uniform fiduciary standard of care under the Dodd-Frank Act if necessary. This legislation is a prudent step to consider as work continues on establishing a standard based on IRI's core principles. The objective of this process should be to establish a standard that increases consumer protections, prevents investor harm and avoids investor confusion, while preserving access to financial products and avoiding market disruptions. Congresswoman Wagner's legislation seeks to achieve that goal, and we applaud her leadership on this issue.

Meeting Consumers Retirement Income Needs

Americans today are living longer than ever before, while access to traditional defined benefit pension plans continues to decline and health care costs continue to rise, creating a significant risk that far too many Americans – more than 30 million Baby Boomers and nearly half of all Gen Xers – will outlive their savings. Middle-income Americans seeking a financially secure retirement are faced with challenges that simply did not exist for their parents and grandparents.

Outside of Social Security and private pensions, annuities are the only source of guaranteed lifetime income to help retirees ensure they will not outlive their savings in retirement. Only insurance companies and their distribution partners can provide these products. With proper planning and use, annuities can provide retirees with guaranteed lifetime income and the

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security of knowing they will not outlive their savings. IRI research has shown that Boomers who own insured retirement products, including all types of annuities, are more confident in their overall retirement expectations and are more likely to engage in positive retirement planning behaviors, with 68 percent having calculated a retirement goal and 63 percent having consulted with a financial adviser.

Annuities appeal to Americans of all income levels and consumers who do not have access to other retirement savings vehicles. In fact, annuity owners are overwhelmingly middle-income. Seven in 10 annuity owners have annual household incomes of less than $100,000. Unfortunately, the DOL proposal would significantly limit consumer access to these critical lifetime income guarantees through employer-sponsored retirement plans and IRAs at precisely the point in time when access to them is most needed.

Support for a Workable Best Interest Standard

As I noted above, IRI and our members support a best interest standard for financial professionals who provide personalized investment advice or recommendations to plans, plan participants and beneficiaries, and IRA holders. We believe the vast majority of financial professionals already act in their clients' best interest, and recent IRI research found that nearly all consumers agree. It is critical, however, that the establishment of a best interest standard does not inadvertently limit plan participants and IRA investors access to a broad spectrum of guaranteed lifetime income products, from living benefits to immediate annuities to deferred income annuities and qualifying longevity annuity contracts (QLACs).

DOL can easily avoid this outcome by (a) revising the prohibited transaction exemptions (PTEs) in the proposal to provide a clear and workable path for advisers and financial institutions to make these products available to their clients, and (b) clarifying the proposed definition of "fiduciary" and the proposed carve-outs from that definition to establish a more appropriate threshold for the imposition of fiduciary status.

Need for Workable PTEs to Preserve Access to Guaranteed Lifetime Income

The proposal includes two PTEs upon which financial institutions and advisers can rely to make annuities available to their clients – a new "Best Interest Contract" Exemption (the BIC Exemption) and a revised version of existing PTE 84-24. IRI's comment letter identified a number of concerns regarding both of these PTEs and recommended specific changes DOL should make to address those concerns.

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Definition of Best Interest is Needlessly Restrictive

Both the BIC Exemption and PTE 84-24 would require that advisers act in the best interest of their clients. As noted above, IRI and our members support this concept. However, the definition of "best interest" in the proposal is impractical, unnecessary and unworkable because it would require that advisers act "without regard to" their own legitimate financial and business interests. IRI suggested this definition be modified to clearly require that advisers and financial institutions always put their clients' interests first, without requiring advisers and financial institutions to have no interest at all. Without this change, it will be impossible for any adviser or financial institution to rely on either PTE 84-24 or the BIC Exemption, meaning millions of Americans would lose access to advice and to products that provide guaranteed lifetime income.

Disparate Treatment of Variable Annuities is Unnecessary and Inappropriate

The proposal would remove sales of variable annuities to IRA owners from the scope of PTE 84-24, an exemption that has been in place for both variable and fixed annuities for over 30 years. This change would limit choice for retirement savers by strongly discouraging the sale of variable annuities, which offer retirement savers an essential and unique vehicle for accessing guaranteed lifetime income while still retaining some effective control over investments. However, DOL has not provided any evidence to support the need to treat variable annuity sales to IRAs any different than other annuity sales to retirement savers. Rather, this change appears to be based on an inaccurate perception that variable annuities are simply a "package" or "bundle" of mutual funds and should therefore be treated as such.

In fact, variable annuities are much more like fixed annuities than mutual funds and other securities products. All fixed and variable annuities, whether registered as securities or not, are insurance products that provide guaranteed lifetime income. While variable annuities have investment features, the products' benefit base and lifetime income guarantees are the primary attributes that make them attractive to many consumers. In addition, variable annuities commonly include multiple layers of meaningful guarantees, including: one or more fixed investment options, with both periodic and lifetime crediting rate guarantees, alongside a set of variable investment options; living benefits providing lifetime income guarantees; death benefit guarantees; and guarantees of the right to convert all or a portion of the contract to an income for life or for joint lives.

IRI has strongly urged DOL to restore variable annuities sales to IRAs to the scope of PTE 84-24. IRA owners would still receive the protections of a best interest standard (which would be added to this PTE under the proposal) and reasonable compensation requirements (which are already part of PTE 84-24), as well as existing disclosure and sales practice rules under SEC, FINRA and state insurance regulations.

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To be clear, IRI believes both PTE 84-24 and the BIC Exemption (with the changes described below) would provide appropriate levels of consumer protection with respect to annuities, and that both exemptions should therefore be available for sales of all types of annuities so advisers and financial institutions can have the option to choose the path that makes the most sense for their respective businesses and clients.

BIC Exemption is Unworkable for Annuity Products

IRI believes many of the conditions included in the proposed BIC Exemption will be so onerous or impossible to comply with that lifetime income products and vital sources of annuity product distribution information will no longer be available to consumers. IRI has provided DOL with extensive feedback in its comment letter to address concerns about changes needed to make the BIC Exemption workable, including suggestions with respect to the logistics of the required "best interest contract" and the disclosure requirements. While this testimony is not intended to restate all of our concerns and recommendations, I do want to highlight two of our other specific issues regarding the BIC Exemption.

The first relates to conditions included in the proposed exemption regarding "reasonable compensation" as it would apply to annuity products. The BIC Exemption would measure reasonable compensation strictly in relation to the value of services provided by the adviser and the financial institution. While that may seem sensible on its face, it fails to account for the costs associated with the guaranteed features of annuity products, which are the main reason most consumers decide to purchase these products as part of their overall retirement income plans. IRI recommended to DOL a simple and straightforward solution to address this issue by which DOL can incorporate the same distinction into the BIC Exemption for purposes of measuring reasonable compensation in the context of annuity transactions that is contained in the proposed amendments to PTE 84-24, which distinguishes between amounts paid for services provided and amounts paid for the annuity contract itself.

The second point on the proposed BIC Exemption relates to its impact on proprietary annuity distribution models. Many insurers offer proprietary investment menus under their variable annuity contracts and IRA products. Similarly, a number of insurers have career agents who contractually agree to limit their annuity sales and servicing efforts primarily or exclusively to the insurer's own products. These insurers may sponsor benefit plans to cover qualifying career agents, provide office housing allowances and offer substantial training and education support.

The proposed BIC Exemption implies that such arrangements are inherently problematic by imposing additional conditions on advisers and financial institutions that offer only proprietary products. These conditions would create a bias in favor of advisers and firms that offer unlimited product choice and against those that choose to develop more extensive expertise on a smaller universe of products. The benefits of the proprietary distribution business model are

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vital to a healthy marketplace and need to be preserved. IRI recommended that DOL remove these additional conditions on advisers and financial institutions that offer only proprietary products and clarify that merely offering such products would not subject them to any additional requirements in order to satisfy the BIC Exemption.

Proposed Definition of "Fiduciary" is Overly Broad

The proposal would significantly expand the circumstances under which a person giving investment advice to a plan, its participants, or an IRA owner would be considered a fiduciary under ERISA and the Internal Revenue Code. In the preamble to the proposal, DOL explains that the goal is to define "fiduciary" to clearly include relationships that are appropriately regarded as fiduciary in nature and clearly exclude those that are not. However, the proposed definition is so broad that it captures many customary financial marketing and sales activities where no reasonable consumer would expect a financial professional to perform such activity as their fiduciary. By way of example, the definition would include each of the following activities:

- Giving a mere factual description of the features of an annuity product, such as an immediate fixed annuity or a deferred variable annuity, and explaining how the product can meet certain needs;
- Answering questions from plan participants about the operation of a specific "in-plan" guaranteed lifetime income product and its available features;
- Proprietary product "wholesaling" activities where representatives of an annuity product manufacturer meet with financial professionals – either one-on-one or in group sessions – to explain the features of the product and to conduct training; and
- Counseling a recent retiree about his or her likely income replacement needs and the features available under various annuity products that could help meet those needs.
- Routine customer service provided by a call center.

If the fiduciary definition is not narrowed to clearly exclude activities not fiduciary in nature, millions of Americans with modest means or who are just starting to save will lose access to the information and advice they need to help them plan for a secure and dignified retirement. IRI offered a number of recommended changes to the proposed definition of "fiduciary" to distinguish between conduct that is properly considered and understood to be fiduciary in nature and clearly non-fiduciary sales and marketing activities.

Although DOL has provided a number of so-called carve-outs from the proposed definition that in theory could alleviate these concerns, those carve-outs are too narrowly tailored to do so.

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First, the proposal includes a counterparty carve-out designed to allow advisers and financial institutions to engage in basic sales activities without becoming a fiduciary (commonly referred to as a seller's exception). Unfortunately, this carve-out is not available for most retail transactions, such as those involving small 401(k) plans or individual participants, beneficiaries or IRA owners. The proposal justifies the limited availability of this carve out based on the view that, "as a rule," recommendations to small plans and individual customers do not fit the arm's length characteristics the carve-out is intended to preserve.

IRI disagrees with this premise, and therefore urged DOL to provide a carve-out from fiduciary status for a person who: "provides advice or recommendations . . . under facts and circumstances where there can be no reasonable expectation on the part of the advice recipient that the advice provider is undertaking to provide unbiased and impartial advice." Absent such change, tens of thousands of small businesses will either not open retirement plans for their employees or will not maintain their current plan, and millions of Americans with low and moderate savings will not receive information and advice to help them plan for a secure and dignified retirement.

Another important carve-out in the proposal relates to investment education. While DOL expanded investment education to include education about distribution options, the proposal nevertheless impairs the ability of advisers and financial institutions to provide meaningful investment education because it excludes discussions of specific investment alternatives from the definition of investment education. IRI believes the existing guidance under Interpretive Bulletin 96-1 allowing discussions about investment alternatives in connection with asset allocation education is very important for savers, thus IRI urged DOL to revert back to that definition. Otherwise, savers will not be able to know which specific investments match their preferred asset allocation, and they risk choosing investments that do not meet their risk tolerance and needs.

Implementation Period is Impractical and Must be Extended

IRI believes the proposed eight-month implementation period provided by DOL in the rule is simply not feasible. This belief was confirmed by a study recently completed for IRI by Deloitte & Touche on the operational impact of the proposal on the insured retirement industry. The study showed that, given the complex requirements and conditions in the proposal, IRI members would have to undertake massive information technology re-design and build outs that would likely take several years to complete.

The DOL and the financial services industry have recent experience with adoption of a new, more limited disclosure regime in the form of the DOL's regulations under ERISA Section 408(b)(2) in 2012. The implementation date for those regulations, which are much narrower in scope than those contained in the proposed rule, was delayed on several occasions, and

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ultimately extended by more than two years. This was largely in response to logistical issues experienced by the industry in developing new technology and processes to comply with the regulations, and DOL correctly concluded that a longer implementation period was necessary.

The changes that required by this proposed rule are far more extensive and complex. To avoid significant and harmful disruptions in the availability of annuity products and their guaranteed lifetime income features to millions of retirement savers, and advice about whether these products fit their needs, the implementation period should be extended to at least three years.

Regulatory Impact Analysis Omitted Benefits of Annuities, Impact on Capital Markets

While the proposal was accompanied by a lengthy regulatory impact analysis (RIA), numerous commenters have identified serious flaws and raised serious questions about the RIA. IRI would like to highlight two areas in which the RIA was particularly deficient.

The first relates to the lack of any consideration in the RIA of the value of annuities. While the proposal expressly applies to annuities, the RIA fails to consider either the cost to consumers of losing access to annuities and advice about how to use annuities to plan for a financially secure retirement, or the cost to financial institutions and advisers to develop and implement the systems needed to comply with the proposal's extensive conditions and requirements. Before DOL moves forward with the rule, it must carefully study and consider these costs and determine that the benefits afforded by the rule would outweigh those costs.

Second, the RIA did not adequately consider the impact of the proposal on the capital markets and the national economy. Many commenters, including IRI, believe the proposal would ultimately drive the majority of retirement savers to put their money in passively managed indexed funds. DOL and other regulators with responsibility for oversight of the American economy (such as FSOC, Treasury and the SEC) should consider whether an excessive concentration of assets in passive investments would adversely impact capital formation, market liquidity, and the overall functioning of the equity markets.

* * * * *

Thank you for the opportunity to share our views on this proposal. IRI would be pleased to provide any additional information or assistance, or to further discuss these issues with members of the subcommittees.

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Statement of the Securities Industry and Financial Markets Association
Capital Markets and Government Sponsored Enterprises Subcommittee and Oversight and Investigations Subcommittee
September 10, 2015

In April, 2015, the Department of Labor (DOL) issued a re-proposal of a rule that would more broadly define the circumstances under which a person is considered to be a "fiduciary" by reason of giving investment advice under the Employee Retirement Income Security Act (ERISA). We credit the Administration and the Department of Labor for trying to modify their original 2010 retirement regulation proposal to address the significant objections from SIFMA, numerous other groups and Members of Congress from both parties. However, upon review, we find the new proposal to be unworkable.

Our concerns are not with the best interest standard. SIFMA's members have long called for the implementation of a best interest or uniform fiduciary standard of care for brokers and advisors when providing personalized investment advice. On that the record is quite clear. Rather, we disagree with the process whereby one agency is developing yet another standard that will apply to only one sector of the retail investment market. As FINRA highlighted in its comment letter on the rule, the creation of yet another standard, and one that only applies only to retirement accounts, could lead to a customer's investment portfolio being governed by multiple sets of rules. It simply makes no sense that the government would not develop a holistic standard. We believe Congress recognized this when they adopted Section 913 of the Dodd-Frank Act (DFA), which SIFMA supported, and which authorized the Securities and Exchange Commission (SEC) as the primary market regulator to establish a uniform standard across the entire retail market. The bifurcation of standards will create confusion both for investors and the providers who must comply.

The process before us today represents a failure in public policy market place that will disserve the retail investors, particularly the retirement savers, that this rule aims to assist. We believe the

rule, as drafted, will reduce choice and increase cost, and individual savers will have a more complex and confusing landscape.

The proposal is also exceedingly complex and would establish an onerous compliance regime that conflicts with existing securities laws, while subjecting advisers to a new private right of action. In fact, the best interest contract (BICE) and principal trading exemptions are so complex that a number of firms have concluded that they cannot be made operational as designed. SIFMA commissioned a report by Deloitte analyzing the operational impact that found that the proposed rule package is so broad, subjective, and ambiguous in certain areas that it will be impossible to build operational systems and processes to ensure compliance.

Moreover, the Department's Regulatory Impact Analysis (RIA) fails to show how this proposal would benefit the public quantitatively, and also underestimates the potential harm it may cause to American investors. An analysis conducted by NERA Economic Consulting on SIFMA's behalf found that the Department's RIA produces estimates that vary widely over an incredible set of values, and the range of numbers is so wide as to suggest no scientific confidence in the Department's methodology. As a result, the estimates in the Department's analysis provide little confidence as to the actual benefits, if any, arising from the proposal. Further, in its analysis of the costs associated with compliance, the Department greatly underestimates the cost to implement and comply with the rule. Deloitte conducted a survey of SIFMA member firms to estimate the actual cost of compliance and found start up and ongoing costs to be almost double the Department's estimates.

Finally, beyond the complexity of the new BICE and principal trading PTE, the rule and attendant PTEs contain so many issues that either dramatically change existing structure, raise questions of interpretation or, as we've been told in meetings with the Department, are not what was intended, that we believe the rule is unworkable in its current form and question how the Department could move to a final rulemaking without substantial changes. In fact, the Secretary has publicly stated that the rule will be subject to "material changes." Its worth noting that as our industry has been working to implement hundreds of new rules prescribed under the Dodd-Frank Act, many which are equally complex and call for new regulatory architecture as that

proposed by the Department, regulators have afforded significantly more time and flexibility in implementation, and utilized their exemptive authority to avoid market disruption. The Department's proposal sets an unreasonable, and unworkable, implementation schedule, and importantly lacks sufficient exemptive relief authority similar to that of the SEC and CFTC. If after reviewing the numerous substantive comments received, the Department chooses to proceed with a rule making,, we believe the Department at the very least, should re-propose before going to a final rulemaking to avoid unintended market disruption.

Industry's Support for a Best Interest Standard

SIFMA and the broader financial services industry have long advocated for a best interests standard when providing personalized investment guidance. This included explicit support for Section 913 of the DFA during its initial consideration in the House of Representatives and subsequently in the final conference report. Further, SIFMA has filed numerous comment letters with the SEC, not only to furnish relevant data and information, but also to provide a roadmap on how to implement the uniform standard of conduct required under Section 913. Specifically,

- In November 2010, we submitted a joint SIFMA/Oliver Wyman study to the SEC to help assess the impacts of changing the existing standard of care.
- In July 2011, SIFMA submitted to the SEC a detailed framework for potential rulemaking under a uniform fiduciary standard.
- In May 2012, SIFMA provided the SEC with even greater detail about our proposed rulemaking framework under Section 913.
- In July 2013, SIFMA submitted detailed cost-benefit data to the SEC to inform their Section 913 analysis and to promote forward progress.
- And, most recently, in June 2015, SIFMA published a proposed best interests of the customer standard for broker-dealers that could be accomplished through amendments to FINRA rules.

Under the existing, comprehensive regulatory scheme administered by the SEC and FINRA, broker-dealers today are increasingly being held to a higher standard that includes many elements of a fiduciary or best interests of the customer standard. Plus, through the collective

action of regulatory guidance, examinations and enforcement, and securities litigation and arbitration rulings, all of which apply to broker-dealers in a more robust and comprehensive manner than the investment advisor model, broker-dealers are running their businesses with a fiduciary standard in mind. In fact, the most common claim in FINRA arbitration is breach of fiduciary duty.

Although broker-dealer regulation and oversight is already quite strong, we nevertheless continue to strongly support the establishment of a best interests standard for all financial advisors that covers the entire retail market place, and not just one sector. While the DOL and the IRS have jurisdiction over retirement products such as 401k plans or IRAs, brokers' and advisers' conduct with respect to such accounts is primarily governed and regulated by the SEC and FINRA (which the DOL appears to recognize at least in its reference to the FINRA arbitration process as a means for investor redress under the rule). Thus, we continue to advise that the SEC, and not the DOL, is the appropriate and expert agency to establish a uniform standard of care for brokers and advisers. That said, however, we do not necessarily take issue with the DOL's definition of a best interest standard, which we believe is fairly consistent with SIFMA's long-standing advocacy in support of such a standard.

Rather, we take issue with the hundreds of pages of extraneous conditions, restrictions, and prescriptions on top of its proposed best interest standard that our members believe create an unworkable set of rules in their current form. The clear consequence of the Department's heavy hand is the explicit and implicit limitation on the types of investments individuals may choose to utilize with their retirement funds, as well as how they choose to pay for the services they seek. We question whether it is appropriate for the government to effectively substitute its judgment for that of every IRA owner, every plan fiduciary and every plan participant, and whether that is what Congress intended when it enacted ERISA.

Concerns with the Rule

We believe the rule as proposed has many issues. For instance,

- The Department seeks to turn sales pitches and "cold calls" into fiduciary conversations. The Department has made it clear that a recommendation by a financial professional to a total stranger, who has no expectation of a fiduciary relationship, and no expectation that he or she is getting "trusted investment advice", will cause the financial professional to be a fiduciary if he or she is subsequently hired. It turns broadly disseminated research into fiduciary advice that is "specifically targeted to" an individual because he or she is one of the millions of people on a financial institution's mailing list.
- The proposal so narrows "financial education" that only those already educated will understand what they are being told under the Department's proposed regime. The proposed education exception is expanded to cover IRAs; however, it does not allow for the naming of individual investment options. The provider would only be able to provide guidance that includes broad asset classes. Giving asset classes without allowing examples will not help participants. The Department's proposal would morph all of these educational and common sense conversations that are intended to help people prepare for retirement into "fiduciary" conversations, subject to a whole new restrictive, burdensome and liability-filled regime.

- The Department's proposal would also pull in all distribution and "rollover" conversations. These are conversations that a provider has with an individual about moving their assets out of their old employer's plan and into an IRA, which might help that individual keep better track of the funds, and take a more active role in managing their funds. SIFMA does not believe distribution recommendations are fiduciary advice. We do not believe that it is in the best interest of plan participants to discourage all conversations regarding distributions. By discouraging these conversations, leakage (dropping) out of the retirement system becomes far more likely.
- The proposed seller's exception leaves out services entirely, making it impossible for a large plan, collective trust, or other admittedly sophisticated plan to buy futures, clear a trade, or trade securities or custody their securities. Small plans and all retail investors are left out. It is simply not reasonable, and is entirely inconsistent with the views of primary securities regulators, to assume that no amount or type of disclosure would be found sufficient to alert a listener to the fact that a conversation involves selling, that it is

not "trusted advice". The securities laws have been grounded on an understanding that most investments can be clearly explained and their fees clearly identified. Only the Department believes that clear and concise disclosure is not enough.

- Furthermore, neither the seller's exception nor the BICE are available to participant directed plans with fewer than 100 employees, an omission which could result in small plan sponsors electing not to offer retirement plans because they are unable to obtain meaningful assistance from advisers or service providers with respect to plan investment options. This could reduce the number of plans that are established, and possibly lead to termination of existing plans. For those plan sponsors who continue to sponsor plans, they will be selecting investment lineups for the plan participants with limited help.

BICE and PTEs

The proposed exemptions that are intended to allow plans and IRAs to continue their current access to the markets will have the opposite result. Virtually all of the new exemptions and the proposed amendments to existing exemptions are simply not administrable. We note that the Department's statutory authority to grant exemptions requires that they be administrable. These proposals simply don't meet the statutory standard.

The Best Interest Contract Exemption explicitly and implicitly limits client choices on the investments they can make, a dictate unprecedented in ERISA's 40-year history. It raises significant and in some cases insurmountable obstacles for broker-dealers including by inference the establishment of level fees between product providers and distributors, which has the effect of government setting fees and ignores market realities. It requires a disclosure regime that will not only overwhelm the customer with more information than the customer can possibly digest, but also impedes customer transactions, conflicts with existing securities laws such as FINRA Rule 2210 and in some cases may not be possible to construct. It will establish a new supplemental private right of action. And, it will require firms to establish duplicative and redundant compliance regimes, duplicative systems, training, client contracts, trade confirmations and periodic statements: one set for tax deferred accounts, and another for non tax deferred accounts.

The requirements of the Principal Trading Transaction Exemption cannot be met in the context of best execution. Retirement clients will get worse pricing and delayed execution. Financial market fluctuations will create situations where there are changes to prices, credit ratings or liquidity conditions in the time between the initial transaction disclosure recommendation and the customer's decision to execute the transaction. For a broker-dealer to stay in compliance with the exemption, and as securities fluctuate in liquidity and credit rating, the investment professional would be allowed to sell a security to a client but not allowed to buy it back, eliminating one of the hallmarks of an orderly securities market. Delays caused from performing such repetitive disclosures may have unintended harmful consequences to customers such as best execution requirements and pricing disparities. Broker-dealers would be required to create systems that identified fixed income securities by CUSIP based on liquidity and credit risk, and update the information continuously, many times a day, to make sure that the terms of the exemption were met all during the trading day and that no "impermissible" securities could be sold. And many securities currently sold on a principal basis could only be bought and sold on an agency basis, adding commissions to third party markups to the detriment of retirement savers.

Many of the requirements of both the BICE and the proposed Principal Trading Transaction Exemption are so broad, subjective, and ambiguous that it would be impossible to build systems and processes to ensure compliance or to create objective standards for surveillance. Terms are not defined, and when they are, new definitions have been proposed when a perfectly adequate definition exists in FINRA rules. Compliance with the terms and conditions of any, or all, of these exemptions, would impose significant additional costs and liability on brokers-dealers which could cause them to change their business models in an effort to avoid unnecessary risk and punitive excise taxes for failing to meet an entirely subjective or vague, undefined standard. These costs get passed on to the clients.

Further, to the extent that our members can build and implement the systems required, the duplication and costs are far greater than that the Department claims. Our members, most of whom provide both commission brokerage and investment advisor fee based accounts, believe

that the proposed rule and particular the BICE are so complex and onerous and the liability risks so uncertain that they likely would elect not to utilize the exemption and instead migrate much of their IRA activity to managed accounts. This would result in greater costs because of the business and regulatory structure of such accounts, with retirement savers having to pay for services they have already chosen not to buy. Further, it may well conflict with concerns from the SEC, the primary markets regulator, that buy and hold accounts should not be in wrap or fee based accounts. But importantly, most firms set a threshold balance for their fee based accounts offered, usually around $50,000 AUM, because of the costs associated with managing such accounts. As most IRA's have balances below $50,000, many if not most would not be migrated. Further, those with higher balances have already chosen what type of account and services they wish to purchase and thus may not be inclined to be placed in a fee based account.

Impact on Asset Managers

SIFMA's Asset manager members are concerned that the expanded definition of investment advice will hamper their ability to act in the best interest of these clients. Asset managers will be less able to provide information and education than they are today. They may also be restricted in making available services and/or products or may only be able to do so at greater expense. In addition, because the proposal broadly imposes fiduciary obligations on market participants with whom asset managers transact on behalf of plans, those market participants will be less willing to engage in activities and services that assist in carrying out one's fiduciary duties, and will restrict information where providing it may transform their role into a fiduciary one. Moreover, asset managers and investors, already deemed sophisticated, will be burdened by standards designed for retail retirement savers.

Further, asset managers, separate and apart from their role as fiduciaries to plans, create and manage registered mutual funds, exchange traded funds, real estate investment trusts and hedge funds and other private funds that are purchased as investments for plans. Because different plans will have different investment objectives, different products and strategies will be best suited to help investors achieve their objectives. As drafted, the proposed rule and Best Interest Contract Exemption will result in substituting the variety of products currently available with a

de jure or de facto "legal list," and make the burdens of offering many funds and products effectively prohibitive. Asset managers are concerned that both the proposed rule and the BICE will have the effect of limiting or restricting asset managers' products that are available to plans and promoting certain types of products (e.g., low-cost index products) over others.

Regulatory Impact

The Department's regulatory impact analysis fails to show how this proposal would benefit the public quantitatively, ignores potential costs to investors and greatly underestimates costs to providers. In its analysis of the "benefits" of the proposal associated with curtailing purportedly conflicted advice, the Department misapplied academic research that is key to its conclusions. And the range of estimates of benefits is so wide as to raise serious questions about its applicability and credibility.

The Department has no study data to compare the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor who is not a fiduciary, which is core to its asserted benefit. The Department cannot reasonably conclude that investors would be better off under an expanded fiduciary standard on the basis of the studies cited. In fact, NERA's analysis of actual account level data demonstrates that commission-based accounts do not underperform relative to fee-based fiduciary accounts.
To study the costs associated with the DOL proposal, SIFMA engaged NERA who collected account-level data from financial institutions in order to construct a sample of retirement accounts. The dataset includes tens of thousands of IRA accounts over the past four years. Based on member feedback on the proposal, it is highly likely that most firms that offer retirement account services will be unable to offer commission-based accounts to retirement savings customers under the proposal, even under the BICE. Based on that premise, NERA found that:

- Certain commission-based accounts would become significantly more expensive when converted to a fee-based account under the Department's proposal. The increased cost is approximately 50 basis points (bps) - about half a percent per year - for relatively small accounts - those with balances below $25,000;

- A large number of accounts do not meet the minimum account balance to qualify for an advisory account. If the account a minimum balance is $25,000, over 40% of commission-based accounts in our dataset would not be able to open or convert to fee-based accounts. Using a $50,000 threshold, over 50% of accounts would not meet minimum balance requirements for a fee-based account. The DOL proposal, beyond a passing reference to ROBO advisers, is silent on where these accounts would go for services;
- At the heart of the DOL proposal is the contention that commission based account holders face a conflict of interest that causes investment losses. When NERA looked at investment returns, the data showed no evidence that commission-based accounts underperform fee-based accounts. Over the time periods for which NERA has data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees;
- As is outlined in the earlier NERA white paper on the Department's economic analysis, the Department misinterprets the referenced academic literature.

In addition, a key finding of the NERA study is that customers currently can and do choose the fee model that best suits their needs and trading behavior. In the data sample, half the commission based accounts in 2014 traded less than seven times. They would have paid more for those six trades in a fee-based account. By comparison, most fee-based accounts traded more than 50 times each year. Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based account.

We also question the Department's cost estimates for complying with its proposal. The Department's cost estimates rely primarily on data submitted by SIFMA to the SEC in response to a request for information related to Dodd-Frank Section 913 in 2013 (the "SIFMA Data"). Such reliance is inappropriate. The SIFMA Data was collected and submitted by SIFMA to the SEC for the sole purpose of estimating the costs of complying with a prospective SEC fiduciary rule established under Dodd-Frank Section 913, under specific assumptions that were applied to such a contemplated SEC approach. Although the Department concedes that "there will be

substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard… ", the Department nevertheless elects to rely on the SIFMA Data as the basis for its cost estimates. The Department's stated reason for doing so is that there are "some similarities between the cost components" in the SIFMA Data and the costs that would be required to comply with the Department's proposal. We submit that based on the prohibited transaction provisions alone, they will look *nothing* alike. We note that FINRA's comment to the Department supports our view.

To help understand the costs of compliance related to the Department's proposal, SIFMA commissioned Deloitte to conduct a survey of SIFMA members' anticipated start up and ongoing compliance costs. SIFMA's Deloitte survey found that the estimated cost to comply with the Department's proposal is considerably greater than the estimates for the broker-dealer industry provided by the Department in its Regulatory Impact Analysis. The results of the survey estimate that, for large and medium firms in the broker-dealer industry, total start-up costs alone would be $4.7 billion and on-going costs would be $1.1 billion. This is nearly double the estimated cost provided by the Department in its analysis. This is not surprising, given that the Department's estimate was based on a narrow dataset that was never intended to measure costs for compliance with this proposal.

H.R. 1090, the Retail Investor Protection Act

Although broker-dealer regulation and oversight is already quite strong, we nevertheless continue to strongly support the establishment of a best interest standard for all financial advisors that covers the entire retail market place, and not just one sector. While the DOL and the IRS have jurisdiction over retirement products such as 401k plans or IRAs, brokers' and advisers' conduct with respect to such accounts is primarily governed and regulated by the SEC. Thus, we continue to advise that the SEC, and not the DOL, is the appropriate and expert agency to establish a uniform standard of care for brokers and advisers.

Therefore, we are pleased that under the H.R. 1090, The Retail Investor Protection Act, the SEC would be required to take the first action in establishing a uniform fiduciary standard. We believe this would be an appropriate step in the right direction. The SEC has the expertise and the long history of regulating the broker dealer industry and ensuring investor protections. Undoubtedly, they would be the most knowledgeable and effective regulator at both establishing a uniform best interest standard and ensuring it is properly implemented by the industry.

H.R. 1090 also requires the SEC to analyze the issues surrounding the establishment of a uniform fiduciary standard, and to consider alternative remedies to investor confusion. To help pave the way for the SEC to pass a meaningful best interest standard, we believe the bill could be further improved by requiring the SEC to consider both the quantitative and qualitative benefits to retail customers of a uniform fiduciary standard versus alternative remedies, and by incorporating those considerations into their final cost-benefit analysis.

Conclusion

It is important to consider where others have tried similar proposals, most notably the United Kingdom. The UK put in place a rule known as the Retail Distribution Review ("RDR") in 2013 that sought to address perceived conflicts related to investment advice by banning commission brokerage accounts for retail investors. While the DOL proposal does not explicitly ban such accounts, we believe its prescriptions effectively do so.

According to a survey commissioned by the UK Financial Conduct Authority ("FCA"), several advisors stopped providing retail services and many have instituted account minimums, with some requiring approximately $80,000 or more. Recent reports estimate that 11 million investors have been priced out of the market due to decreased willingness of both financial advisors to provide advisory services and consumers to pay increased advisory costs. The result of the RDR has been the creation of an "advice gap" in the UK. On August 3, HM Treasury announced a new review to address this shortcoming and ensure the regulatory environment allows business models to include affordable and accessible advice. The Department's proposal risks the creation of a similar "advice gap" in the U.S.

SIFMA reiterates its longstanding support for the implementation of a best interests standard for brokers and advisors when providing personalized investment advice to retail clients for all of their accounts, not just their IRAs. Congress, very recently, determined that the SEC was the expert agency to take lead and we believe that is entirely appropriate. Our members feel very strongly that the Department's proposal is far too complex and prescriptive establishing a myriad of new requirements that will be difficult if not impossible to implement, and will result in less education, fewer choices and greater costs to investors which is not in their best interests. Thank you again for the opportunity to testify today.

Written Statement for the Record

U.S. Chamber of Commerce

Hearing entitled "Preserving Retirement Security and Investment Choices for All Americans"

Subcommittees on Capital Markets and Government Sponsored Enterprises and Oversight and Investigations

U.S. House of Representatives

September 10, 2015

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions. The Chamber believes that a coherent, streamlined regulatory structure and effective common sense regulations will ensure the safety and soundness of the financial markets while promoting economic growth and job creation. As the House Financial Services Subcommittees on Capital Markets and Government Sponsored Enterprises and Oversight and Investigations hold a hearing entitled "Preserving Retirement Security and Investment Choices for All Americans," the Chamber would like to share its views on H.R. 1090, the "Retail Investor Protection Act" (RIPA), and the Department of Labor's (DOL) reproposed fiduciary rule.

The Chamber strongly supports H.R. 1090 and its enactment into law. RIPA would require the Securities and Exchange Commission (SEC) to study whether it is necessary to establish a uniform standard of care for providing investment advice to retail customers for investment advisors, brokers, and dealers and, if so, to develop a rulemaking. RIPA would also enhance coordination between the SEC and the DOL by prohibiting the DOL from issuing an expanded definition of fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) until sixty days after the SEC issues a final rule. Without this coordination and comprehensive review, 9 million small businesses may be unable to provide their employees with retirement benefits.

The DOL reproposed a rule modifying the definition of fiduciary investment advice in April 2015 and, since then, thousands of comment letters and many witnesses at the DOL's public hearing have noted the unworkability of the proposal, its harmful impact on retirement savings, and the clear lack of coordination with the SEC. Consequently, the Chamber believes that proper sequencing of standard of conduct rulemakings by the SEC and DOL, and the associated due diligence of

whether the rules are necessary by marketplace regulatory experts, is critical to ensuring that there is continued access to retirement advice and investment products for employees of small businesses, as well as individual retail investors.

Without that coordination and analysis, unnecessary and increasing costs would flow to small businesses, their employees, and retail investors. For example, the DOL's proposed fiduciary rule would lead to increased liability and new private rights of action not provided for under the federal securities laws. Another example is the fact that complying with the extensive disclosure requirements under this proposed rule would actually violate the federal securities laws. The costs associated with these changes would inevitably be either passed down to small businesses, their employees, and other retail investors or reflected in the inability of financial advisers to no longer serve investors with lower-balance retirement savings due to the prohibitive cost of doing so.

Moreover, as history has shown, the DOL and SEC have often worked at cross-purposes on their fiduciary initiatives, with the DOL failing to adequately consider the current regulatory structure applicable to investment advice. The Financial Industry Regulatory Authority (FINRA), the independent self-regulatory organization responsible for the broker-dealer industry and investor protection and overseen by the SEC, has publicly noted this lack of coordination and the failure of the DOL's proposed rule to build upon the existing regulatory system under the federal securities laws. RIPA would address this issue by requiring the SEC to act first in issuing a standard of care rulemaking and requiring the SEC to consider differences in registration, supervision, and examination requirements applicable to brokers, dealers, and investment advisors before issuing a rulemaking.

The Chamber also supports RIPA's common sense requirements to identify the costs of, or alternatives to, any standard of conduct rulemaking issued by the SEC. RIPA would require the SEC to (1) identify any issues with the current fiduciary structure; (2) consider alternative remedies to reduce confusion or harm to retail investors, including the simplification of titles and enhanced disclosure; and (3) identify whether uniform standards of conduct for broker dealers and investment advisors would have any adverse impact, resulting in reduced products and services for retail investors or a lack of personalized and cost-effective investment advice. These measures would help ensure the appropriate balance in investor protection while mitigating potentially harmful consequences.

More broadly, RIPA is necessary because of the clear lack of consideration the DOL has given to the impact of its proposed fiduciary rule on small businesses and their employees. As detailed more extensively in the Chamber's comment letters to

the DOL, there are three main issues with the proposed fiduciary rule: (1) the "seller's carve-out" would discriminate against small businesses by excluding small plans, participants, and IRAs; (2) the "best interest contract" exemption would increase the cost of providing services to small businesses and could potentially eliminate access to investment advice completely; and (3) the "education carve-out" would unnecessarily restrict investment assistance and harm small business retirement plan participants. The DOL's failure to address these issues would cause irreparable harm to the ability of small businesses to provide retirement plans and deny small business employees access to quality retirement advice and products.

The contribution of small business employers to retirement savings in the United States should not be underestimated. The Chamber's recent report, *Locked Out of Retirement: The Threat to Small Business Retirement Savings*, notes that small business owners provide roughly $472 billion in retirement savings for over 9 million U.S. households through Simplified Employee Pension (SEP) and Savings Incentive Match Plan for Employees (SIMPLE) type IRA plans.[1] Employees that participate in SEP and SIMPLE IRAs are at particular risk of losing access to retirement advice or products given the sheer compliance burden and litigation risk facing advisors under the proposed rule.

It is also important to realize that, by virtue of their role in America's economy, small businesses play a critical role in providing retirement plans to Americans. According to the Small Business Administration's ("SBA") Office of Advocacy:

- There are more than 28 million small businesses in America.
- Small businesses are 99.7% of all businesses.
- Small businesses employ just under half of all private sector employees, and pay 42% of total U.S. private payroll.
- Small businesses generated 63% of net new jobs between 1993 and mid-2013 and accounted for 60 percent of net new jobs from mid-2009 to mid-2013.

Small business employees are a significant part of the U.S. workforce, many of which rely on financial advisers linked to their employer's retirement plan for access to investment advice and services that would otherwise not be available. However, the DOL's proposed fiduciary rule would reduce and in some cases even eliminate those important benefits by requiring advisors to change how their products and services are structured and how the retirement plans and IRA accounts are charged

[1] A copy of our report is included as an appendix to our statement for the record. The report is also available at the following link: https://www.uschamber.com/sites/default/files/us_chamber_-_locked_out_of_retirement.pdf.

fees. Those required changes would result in a dramatic reduction in access to investment advice and services for small business employees. However, there is no clear indication of whether those individuals would have any access to investment advice or retirement savings options at all.

For these reasons, the Chamber strongly supports H.R. 1090, the "Retail Investor Protection Act," and endorses its swift passage as it would allow the SEC to consider the impact of a uniform standard of conduct on small businesses and their employees. In addition, the attached letter shows over four hundred small businesses, associations, chambers of commerce, and organizations weighing in on the serious impact this rule would have on small businesses and the retirement savings of their employees. The Chamber appreciates the opportunity to submit this statement for the record and would be glad to assist the subcommittees in any way in providing continued support for RIPA and the subcommittees' oversight of the DOL's fiduciary duty rule.

July 21, 2015

TO THE MEMBERS OF THE UNITED STATES CONGRESS:

The undersigned associations, chambers of commerce, organizations, and small businesses are writing to express our serious concerns regarding the U.S. Department of Labor's ("DOL") proposed rulemaking regarding the Conflict of Interest rule. If finalized in its current form, the proposed rulemaking will disproportionately disadvantage small businesses and stifle retirement savings for millions of employees by placing additional burdens on America's leading job creators, small businesses. This will substantially reduce retirement savings for many Americans.

On April 20, 2015, the DOL proposed a rulemaking that expands what is considered fiduciary investment advice under the Employee Retirement Income Security Act ("ERISA"), negatively impacting small business retirement plans. Through SEP IRAs and SIMPLE IRAs, small business owners and their employees have accumulated approximately $472 billion of retirement savings covering more than 9 million U.S. households.[1] The DOL proposal threatens the continued success of these plans and the ability of small businesses to provide retirement security at a time when millions of Americans have reached or are approaching retirement age.

First, the proposal makes it harder to provide retirement plans to small businesses. The broadened definition of investment advice includes "sales" communications, certain educational materials and other situations where no intention to provide individualized fiduciary advice has been expected. However, the proposal carves out large plan advisors from this definition. If a plan has 100 or more participants, or $100 million or more in plan assets, the advisor to that large plan does not have to be a fiduciary, while an advisor to a small plan does. ***Because an advisor to a small plan is not carved out of the rule, the advisor who is trying to market retirement saving options to a small plan is considered to be providing investment advice and must determine how to comply with the rule. Advisors to large plans are not burdened with these additional hurdles.*** Due to these additional burdens, advisors to small plans are likely to incur additional costs, which will be passed on to the plan. Further, some advisors to small plans may be incentivized to no longer offer their services to small plans if they determine that the small-scale of such plans means the expense and risk of changing business models and fee structures is not justified.

Second, because advisors to small businesses are not carved out of the investment advice definition, they must either change their fee arrangements or qualify for a special rule called an "exemption" in order to provide services on the same terms as before. ***However, the new exemption proposed by the DOL may not apply to small business plans.*** It does apply to individual owners of IRAs, but it is not clear whether this exemption is available for SEP and SIMPLE IRAs while they are being offered by the employer. ***Even if the new exemption—***

[1] *See* Investment Company Institute, "How Many Households Own IRAs," based on year-end 2012 data, *available at* http://www.ici.org/faqs/faq/faqs_iras.

called the "Best Interest Contract Exemption"—does apply, it would itself substantially increase costs for advisors due to its many conditions and requirements.

More complex regulations mean more hurdles and compliance costs and a greater likelihood of lawsuits. Main Street advisors will have to review how they do business and likely will decrease services, increase costs, or both. Under the proposed rule, small business SEP IRA and SIMPLE IRA arrangements will become more expensive to serve, meaning that small businesses will ultimately lose access to their advisors and disproportionately bear the costs of excessive regulation. ***Consequently, the DOL's proposed regulations risk hurting the very small businesses and workers they are intended to protect.***

Sincerely,

1st Liberty Financial	Pine Mountain Club	CA
2H Design	Charlotte	NC
312 Desgins, Inc.	Troy	OH
a-1 catering	Hawthorne	CA
Absolute Automotive	Troy	OH
Access Affordable Benefits, LLC	Kissimmee	Fl
Adamson Financial Planning	Marion	IA
Advanced Foot & Ankle Care Centers of Ohio	Tipp City	OH
AFC-MD Benefits Consultants, LLC	Crossville	TN
AHNE	Concord	NH
Albany Area Chamber of Commerce	Albany	OR
Alsco	Knoxville	TN
American Council of Engineering Companies	Washington	DC
American Insurance	Johnstown	PA
Ameriprise Financial	Muncie	IN
Ameriprise Financial Services LLC	Fort Wayne	IN
Ames Chamber of Commerce	Ames	IA
Anderson Area Chamber of Commerce	Anderson	SC
APPA Para Medical Services	Las Vegas	NV
Ardmore Chamber of Commerce	Ardmore	OK
AREAS Appraisers, Inc.	Springfield	VA
Ashland Area Chamber of Commerce	Ashland	OH

Association Business Services, LLC	Ladue	MO
Association for Advanced Life Underwriting	Washington	DC
Atlas for Educators, LLC	Goshen	IN
Avery Group Insurance and Financial Services	Centennial	CO
B & I Agencies Co.	Wabash	IN
Baltimore Washington Corridor Chamber	Laurel	MD
BAMR, LLC	Louisville	KY
Baytown Chamber of Commerce	Baytown	TX
Beckley-Raleigh County Chamber of Commerce	Beckley	WV
Beltway Movers Associates, Inc	Alexandria	VA
Benefits Plus	Lexington	KY
Bennett Office Technologies, Inc.	Willmar	MN
Berger Benefit Connections	Dubuque	IA
Berkeley Chamber of Commerce	Moncks Corner	SC
Bilitz Financial	Fond du Lac	WI
Bill Houk Agency, Inc.	Clinton	MO
Billings Chamber of Commerce	Billings	MT
Blair County Chamber of Commerce	Altoona	PA
Blair County Chamber of Commerce	Altoona	PA
Blue Mango Learning Systems	McLean	VA
Bryon Holz & Associates	Brandon	FL
Bryson Financial	Long Beach	CA
Business Council of Alabama	Montgomery	AL
Buttonwood Investment Services, LLC	Littleton	CO
C & B Ent, Inc	Presque Isle	ME
Cambridge Financial Center	Salt Lake City	UT
Canopy Financial Group	Lakeville	MN
Canyon Small Animal Hospital	Caldwell	ID
Capital Asset Planners, LLC	Oakland	CA
Capital Assurance Associates	Fort Worth	TX
Central Financial Group	Fort Dodge	IA
Cerritos Regional Chamber of Commerce	Cerritos	CA

Charlotte Chamber of Commerce	Charlotte	NC
Cincinnati USA Regional Chamber	Cincnnati	OH
Cincinnati Wellness LLC	Lebanon	OH
Cin-Day Health Services LLC	Lebanon	OH
CIS	Troy	MI
Clark Financial	Lakewood	OH
Client First Financial Services	West Point	GA
CliftonLarsonAllen LLP	Joliet	IL
Clopay Building Products	Troy	OH
Connections Counseling, LLC	Anchorage	AK
Cornerstone Family Office, Inc.	Carlsbad	CA
Corning Area Chamber of Commerce	Corning	NY
CP Winston	Winston-Salem	NC
Crisis Center for South Suburbia	Tinley Park	IL
Dagostino & Briselli	Mechanicsburg	PA
Dang Good Yoga	Escondido	CA
Daves Services	Troy	OH
DBK Consulting	Arlington	VA
Dembo Jones	Rockville	MD
Diversify, Inc.	South Jordan	UT
Dp Financial Services LLC	Layton	UT
Eagle Strategies, LLC	Bend	OR
Ecotec LTD LLC	TROY	OH
Ed Zierold & Associates, LLC	Independence	OH
Education Planning Resources	New Plaestine	IN
Education Planning Resources Indiana, LLC	Noblesville	IN
Ellis Insurance & Financial Group	Baton Rouge	LA
Ellowitch3, LLC	Paramus	NJ
Eminence Financial	Grand Rapids	MI
Emmi & Sons inc.	Baldwinsville	NY
Employee Assistance Professionals Association, Inc.	Arlington	VA
Eric Guenther State Farm	South Bend	IN

Erstad & Company Inc.	Boise	ID
Estate & Pension Plans, Inc.	Jackson	MI
ETF designs	Bedford	Ma
Euclid	West Palm Beach	FL
F.C.Tucker Emge Realtors	Evansville	IN
Fairview Evergreen Nurseries, Inc.	Fairview	PA
Fall River Area Chamber of Commerce & Industry	Fall River	MA
Farmers Agent Matthew Slack	Yorkville	IL
Farmers Financial Services, LLC	Haslett	MI
Federal Title & Escrow Company	Washington	DC
Fenstra Investments	Willmar	MN
Fessler & Langdon	Troy	Ohio
Financial Architects of Virginia Inc	Fredericksburg	VA
Financial Partners Group	Louisville	KY
Financial Security Group	Virginia Beach	VA
Financial Services Institute	Washington	DC
First Financial Group	Bethesda	MD
First Financial Group of Largo	Largo	FL
First International Bank and Trust	Fargo	ND
Firstrust Financial Resources, LLC	Philadelphia	Pa
Friedman Associates	Virginia Beach	VA
Garza & Associates	Oklahoma City	OK
Gateway Chambers Alliance	Cerritos	CA
Geetings, Inc. & G.I. Warehouse Corp.	Pella	IA
Georgia Chamber of Commerce	Atlanta	GA
GH MUELLER,LLC	Bloomington	MN
Girish Banaji, DDS PC	Fairfax	VA
Global Vacation Network	Elgin	IL
Gnosis Management Group, LLC	Lebanon	OH
Gordon Marketing	Noblesville	IN
Greater Albuquerque Chamber of Commerce	Albuquerque	NM
Greater Durham Chamber of Commerce	Durham	NC

Greater Flagstaff Chamber of Commerce	Flagstaff	AZ
Greater Louisville, Inc.	Louisville	KY
Greater Miami Chamber	Miami	FL
Greater Oak Brook Chamber of Commerce	Oak Brook	IL
Greater Oak Brook Chamber of Commerce and Economic Development Partnership	Oak Brook	IL
Greater Providence Chamber of Commerce	Providence	RI
Greater Reading Chamber of Commerce & Industry	Reading	PA
Greater Yakima Chamber of Commerce	Yakima	WA
Growth Alliance for Greater Evansville	Evansville	IN
GTM Sales, Inc	Littleton	CO
Gulick Group, Inc.	Reston	VA
Gwen Jorden DDS	Lubbock	TX
H. M. Rosenblatt, Attorney-at-Law, P.A.	Gainesville	FL
Hampton Insurance & Financial Services	Upton	WY
Hanover Area Chamber of Commerce	Hanover	PA
Harford County Chamber of Commerce	Bel Air	MD
Hartley Transportation, Inc	Watertown	SD
Haubert Howe LLC	Troy	OH
Headley Financial Group	Omaha	NW
Heart of Georgia Insurance Brokers, Inc.	Macon	GA
Heartcare CPR INSTRUCTION	Wilmington	DE
Hege Financial Group	Winston Salem	NC
Hess Pumice Products, Inc	Malad City	ID
Hines securities	Katy	TX
Home Instead Senior Care	Burbank	CA
Hot Tops Salon	Huntsville	TX
Illinois Chamber of Commerce	Springfield	IL
Independent Insurance Sales	Oak Island	NC
Indiana Chamber of Commerce	Indianapolis	IN
Indiana Insurance Advisors	Cicero	IN
InsMark, Inc.	Alamo	CA

Insurance & Business Planning, Inc.	Evansville	IN
Investment Center at Crossroads Bank	Wabash	IN
Iowa Association of Business and Industry	Des Moines	IA
Jacobs Financial Services Agency, Inc.	Westlake	OH
Jeff Davis Parish Economic Development, Tourism and Chamber of Commerce	Jennings	LA
Jenkins Associates LLC	Chanhassen	MN
John Pauley & Associates	Charleston	WV
JS Logistics	St Louis	MO
JV Manufacturing, Inc.	Springdale	AR
Kahler Automation Corp.	Fairmont	MN
Kalos Financial, Inc	Alpharetta	GA
Kelley Financial Services, Inc.	Omaha	NE
Kentucky Chamber of Commerce	Frankfort	KY
Kentucky Chamber of Commerce	Frankfort	KY
Kerrville Area Chamber of Commerce	Kerrville	TX
Kingsport Chamber of Commerce	Kingsport	TN
Klamath County Chamber of Commerce	Klamath Falls	OR
Knappen Milling Company	Augusta	MI
Kojetin Insurance and Financial Services	Great Falls	MT
Konen Insurance	Aurora	IL
L.O Thomas & Co., Inc.	Linwood	NJ
Lamont Financial Services	Novato	CA
Landmark Senior Resources Insurance Service, Inc.	San Jose	CA
Lanicom LLC	Troy	OH
Lawrence F Kolasa, CLU, ChFC, LLC	Birmingham	MI
LBA Group, Inc.	Greenville	NC
Lee Goeres Insurance	Missoula	MT
Leichner Financial Group Inc.	Pepper Pike	OH
Lifetime Financial Growrh	Columbus	OH
Lima Allen County Chamber of Commerce	Lima	OH
Lincoln Financial Advisors	Gaithersburg	MD

Lincoln Financial Advisors	Columbia	MD
Lions Eye Bank of NW PA	Erie	PA
Lisa Vandenburgh, Ltd.	Washington	DC
Long Term Financial Solutions, LLC	Tampa	FL
Longview Chamber of Commerce	Longview	TX
Loudoun County Chamber of Commerce	Leesburg	VA
Manjit Singh CPA	Falls Church	VA
Maple Mountain Insurance Services	Mapleton	UT
Mark Carney Insurance Agency	Holly	MI
Maryland Chamber of Commerce	Annapolis	MD
Mass Mutual Agent Francis Surette	Vienna	VA
Mass Mutual Financial Group	Louisville	KY
Massage Envy	Lebanon	OH
MassMutual Agent Edward Vespa	Syracuse	NY
MassMutual Eastern Pennsylvania	Center Valley	PA
McGladrey LLP	Troy	OH
McLean County Chamber of Commerce	Bloomington	IL
MCM Precision Castings, Inc.	Weston	Oh
McNeely Financial Services Inc	Spencer	WI
Mechanical Rubber & Transmission, Inc.	Grand Rapids	MI
Merken Insurance & Investment Services	West Hills	CA
MetLife Agent Brian Addy	Shreveport	LA
MetLife Premier Client Group	Anderson	MO
Miami County Foundation	Piqua	OH
Michigan Chamber of Commerce	Lansing	MI
Michigan Pension Group	Battle Creek	MI
Milledgeville-Baldwin County Chamber of Commerce	Milledgeville	GA
MML Investors Services Inc.	Huntington	WV
Mobile (Alabama) Area Chamber of Commerce	Mobile	AL
Modern Woodmen Of America	Malden	MO
Moshides Financial Group	Amherst	NY
Mutual of Omaha	Oklahoma City	OK

MVP Benefits	North Andover	MA
Myrtle Beach Area Chamber of Commerce	Myrtle Beach	SC
NAIFA	Boston	MA
NAIFA - Kalamazoo	Kalamazoo	MI
NAIFA Cleveland	Valley View	OH
NAIFA-Alaska	Anchorage	AK
NAIFA-Arizona	Scottsdale	AZ
NAIFA-Arkansas	Little Rock	AR
NAIFA-Black Hills	Rapid City	SD
NAIFA-California	Sacramento	CA
NAIFA-Central Jersey	Rutherford	NJ
NAIFA-Charlotte	Charlotte	NC
NAIFA-Connecticut	Hartford	CT
NAIFA-Delaware	Wilmington	DE
NAIFA-Denver	Louisville	CO
NAIFA-Florida	Tallahassee	FL
NAIFA-Georgia	Suwanee	GA
NAIFA-Greater Detroit	Farmington Hills	MI
NAIFA-Greater Washington DC	Washington	DC
NAIFA-Hawaii	Honolulu	HI
NAIFA-Idaho	Meridian	ID
NAIFA-Illinois	Springfield	IL
NAIFA-Indiana	Fishers	IN
NAIFA-Iowa	Cedar Falls	IA
NAIFA-Kansas	Topeka	KS
NAIFA-Kentucky	Louisville	KY
NAIFA-Louisiana	Baton Rouge	LA
NAIFA-Maryland	Annapolis	MD
NAIFA-Michigan	Dewitt	MI
NAIFA-Minnesota	Minneapolis	MN
NAIFA-Mississippi	Jackson	MS
NAIFA-Montana	Kalispell	MT
NAIFA-Nebraska	Lincoln	Ne

NAIFA-New Jersey	Trenton	NJ
NAIFA-New Mexico	Bosque Farms	NM
NAIFA-North Dakota	Bismarck	ND
NAIFA-North Missouri	Edina	MO
NAIFA-Northwest N.J.	Hopatcong	NJ
NAIFA-NYS	Fishkill	NY
NAIFA-Ohio	Columbus	OH
NAIFA-Oregon	Salem	OR
NAIFA-Pennsylvania	Harrisburg	PA
NAIFA-South Carolina	Columbia	SC
NAIFA-Southern Maine	Portland	ME
NAIFA-Springfield	Springfield	MO
NAIFA-Tennessee	Murfreesboro	TN
NAIFA-Texas	Austin	TX
NAIFA-Virginia	Henrico	VA
NAIFA-Washington	Seattle	WA
NAIFA-Wisconsin	Madison	WI
Naperville Area Chamber of Commerce	Naperville	IL
National Association of Insurance & Financial Advisors	Falls Church	VA
National Federation of Independent Business	Washington	DC
Neri Bakery	Greenwich	CT
Nestegg Repairman	Troy	OH
NetWorth Asset Management	Marco Island	FL
New Jersey State Chamber of Commerce	Trenton	NJ
New York Life Insurance D.P. Oppel Associates	Duncansville	PA
New York Life Agent Insurance John Holmes, III	Knoxville	TN
New York Life Insurance Agent Anthony Vallos	North Canton	OH
New York Life Insurance Agent Arthur Smith	Huntsville	AL

New York Life Insurance Agent Barbara Whitmore	Avon	OH
New York Life Insurance Agent Brent Neilsen	Salem	OR
New York Life Insurance Agent Carmine Verrecchia	Bala Cynwyd	PA
New York Life Insurance Agent Collin Scott	Glen Allen	VA
New York Life Insurance Agent Curtis James Jr.	Jacksonville	FL
New York Life Insurance Agent David Bearden	Tucson	AZ
New York Life Insurance Agent Ellen Tillman	Bethesda	MD
New York Life Insurance Agent Janine Ruland	Mill Creek	WA
New York Life Insurance Agent Jessica Bartoszek	Winchester	VA
New York Life Insurance Agent John Pauley	Charleston	WV
New York Life Insurance Agent Jon Stamberger	Highland Heights	OH
New York Life Insurance Agent Jonathan Koepke	Boulder	Co
New York Life Insurance Agent Joseph Grimsic	Medina	OH
New York Life Insurance Agent Joseph Levine	Burleson	TX
New York Life Insurance Agent Kenneth Bakula	Appleton	WI
New York Life Insurance Agent Kristin Byrd	Little Rock	AR
New York Life Insurance Agent Larry McCoy	Seven Hills	OH
New York Life Insurance Agent Lori Kaplan	Beachwood	OH
New York Life Insurance Agent Martha Walp	Brecksville	OH
New York Life Insurance Agent Mary Pat Brennan	Mason	OH

New York Life Insurance Agent Michael Colkitt	Bala Cynwyd	PA
New York Life Insurance Agent Michael O'Neill	Riverside	CA
New York Life Insurance Agent Michael Zorn	Bismarck	ND
New York Life Insurance Agent Nicholas Garofalo	Stratford	CT
New York Life Insurance Agent Rex Floyd	Nacogdoches	TX
New York Life Insurance Agent Rod Bieber	Saginaw	MI
New York Life Insurance Agent Sara Franklin	Charlotte	NC
New York Life Insurance Agent Stanley Kline	Vicksburg	MS
New York Life Insurance Agent Stephen Niple	Seven Hills	OH
New York Life Insurance Agent Suzanne Smaltz	Seven Hills	OH
New York Life Insurance Agent Timothy Moore	San Dimas	CA
New York Life Insurance Agent Walter Scott	Seven Hills	OH
Norse Design Services, Inc.	Tyngsboro	MA
Northern Kentucky Chamber of Commerce	Fort Mitchell	KY
Northern Rhode Island Chamber of Commerce	Lincoln	RI
Northwestern Mutual Agent Barron Weeks	Englewood	CO
Northwestern Mutual Agent Daniel Dalin	East Syracuse	NY
Northwestern Mutual Agent John Haffner	Indianapolis	IN
Northwestern Mutual Agent Kevin Rice	Evansville	In
Northwestern Mutual Agent Matthew Abold	East Syracuse	NY
Northwestern Mutual Agent Michael Kunzler	Provo	UT
Northwestern Mutual Agent Spencer Fitts	Raleigh	NC
Offix LC	Gainesville	VA
Ogden/Weber Chamber of Commerce	Ogden	UT
Ohio Chamber of Commerce	Columbus	OH

OneAmerica	Indianapolis	IN
OneAmerica Financial Partners	Indianapolis	IN
Owen, Wealth & Retirement Strategies	Erdeneheim	PA
Oxnard Chamber of Commerce	Oxnard	CA
Parminder Singh Ahuja, CPA PC	Gaithersburg	MD
Peckinpaugh Financial Group	Muncie	In
Penn Mutual	Ogden	UT
Pennsylvania Chamber of Business and Industry	Harrisburg	PA
Perfect Hose Fittings Assemblies LLC	Denver	CO
Plancorp	Valley View	OH
Platt Financial	Charlottesville	VA
Portenga Manufacturing Company	Ferrysburg	MI
Principal	Dyersville	IA
Principal Financial Group	Martinsville	IN
Principal Financial Group	Salt Lake City	UT
Princor Financial Services Corp.	Mansfield	OH
ProCare Vision Center	Troy	OH
Process Machinery Inc	Shelbyville	KY
Protective Life	Montgomery	AL
Prudential Financial	Scotts Valley	CA
Quad Cities Chamber of Commerce	Davenport	IA
Regional Insurance	Encinitas	CA
Rhode Island Assoc of Ins Agents, Inc.	Warwick	RI
Rice Lake Chamber of Commerce	Rice Lake	WI
Richard Darrah, CLU, ChFC	Corydon	IA
Richland Area Chamber of Commerce	Mansfield	OH
Robert Avery and Associates, Inc.	Denver	CO
Rocco's Ristorante Pizzeria	Walnut Creek	CA
Rockgate Financial Partners	Norman	OK
Rubino and Liang	Newton	MA
Sacry Electric Inc	Whitehall	MT
Sales Automation Support, Inc.	New Berlin	WI

San Jose Silicon Valley Chamber of Commerce	San Jose	CA
Savannah Area Chamber	savannah	GA
SDI, Inc	Little Rock	AR
Seymour & Associates	Sylvania	OH
Shoals Chamber of Commerce	Florence	AL
Simply Made for You	Willows	CA
Sirak Financial Services	Canton	OH
SKG Consulting Group, LLC	Centreville	VA
Skylight Financial Group	Cleveland	OH
Small Business Council of America	Bethesda	MD
Snacktime Vending	St.Marys	OH
Sonnenfeld Financial, Inc.	Winona	MN
South Tex Organics, LLC	Mission	TX
Southern Keystone Services	Alpharetta	GA
Sparkly Cleaning Services, Inc.	Hackensack	NJ
St. Bonore Financial Services	Oak Harbor	OH
State Farm Insurance Agent Brad Jacobson	Cedar Falls	IA
State Farm Insurance Agent Charles Wright	South Hill	VA
State Farm Insurance Agent Chris Neal	Mishawaka	IN
State Farm Insurance Agent Coe Bancroft	Glastonbury	CT
State Farm Insurance Agent Dale Viniard	Crestwood	KY
State Farm Insurance Agent Geral Garcia	San Leandro	CA
State Farm Insurance Agent Jim Metzler	Indianapolis	IN
State Farm Insurance Agent Marcus Edwards	Jeffersonville	IN
State Farm Insurance Agent Michael Berrey	Corvallis	OR
State Farm Insurance Agent Michael Lerdall	Apache Junction	AZ
State Farm Insurance Agent Rick Reid	Granger	IN
State Farm Insurance Agent Robert Gutshall	Parsons	WV
State Farm Insurance Agent Ronal Donelson	South Bend	IN
State Farm Insurance Agent Rose Goheen	Virginia Beach	VA
State Farm Insurance Agent Ryan Sousley	Mishawaka	IN
State Farm Insurance Agent Tim Grauel	South Bend	IN

State Farm Insurance Agent Tom Conley	Agoura Hills	CA
Stephen A Kohn & Associates, Ltd	Lakewood	CO
Sticks & Stones Unlimited, Inc.	Arlington	TX
Strategic Choices Financial	South Pasadena	CA
Strategic Financial Concepts, Inc.	Springfield	MO
Sullivan & Sullivan	Manchester	NH
Superior Excavating	Ashland	VA
Swarthmore Financial Services	New Castle	DE
Templeton Marketing	Albuquerque	NM
The Association of Union Constructors (TAUC)	Arlington	VA
The Golleher Group, LLC	Dickerson	MD
The Greater Boston Chamber of Commerce	Boston	MA
The Hammond Agency, Inc.	Falls Church	VA
The Legend Group	Independence	OH
The Musuneggi Financial Group	Pittsburgh	PA
The O'Connor Insurance Agency	Modesto	CA
The Retirement Advantage, MI	Almont	MI
The United Regional Chamber of Commerce	Attleboro	MA
The Vermont Agency	Colchester	VT
The Witte Co., Inc.	Washington	NJ
Timber Trails RV Park	Decatur	MI
Transamerica companies	Baltimore	MD
Transamerica Financial Advisors, Inc.	Greenville	OH
Trans-Union Customs Service, Inc.	Westlake Village	CA
Tri-City Regional Chamber of Commerce	Kennewick	WA
True North Financial Solutions	Sandy Hook	CT
U.S. Chamber of Commerce	Washington	DC
United Plan Administrators, Inc	Westlake Village	CA
Venus Investments Inc.	Clinton Township	MI
Vonna Husby and Associates, LLC	Fairbanks	AK
Warer Tower Financial Partners LLC	Chicago	IL
Watson Agency, Inc.	Cicero	IN

Wealth Advisory Group	East Greenbush	NY
WealthPlan Financial Partners	Charlotte	NC
Weiss Financial	Carmel	IN
Wenatchee Valley Chamber of Commerce	Wenatchee	WA
West Virginia Chamber of Commerce	Charleston	WV
Wilcox Financial Services, Inc.	Fishers	IN
William A. Hardy Financial Group	Akron	OH
Winner Destination	San Marcos	CA
Woodbury Financial Services, Inc.	Arnold	MO
Wright Veterinary Hospital	Glenwood	AR

cc: The Honorable Thomas Perez, Secretary of Labor
Mr. Jeff Zients, Director, National Economic Council

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

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The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

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Locked Out of Retirement:
The Threat to Small Business Retirement Savings

Bradford P. Campbell, Counsel
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Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

SUMMARY

- Small business owners, through SEP and SIMPLE-type IRA plans, provide roughly $472 billion in retirement savings for over 9 million U.S. households.

- Ninety-nine percent of U.S. employers are small businesses, and they produce 63% of new private-sector jobs. These small business owners and employees need retirement plans at work.

- The DOL is proposing broad new regulations that would impose significant new compliance costs and legal liabilities on advisors to SEP and SIMPLE IRAs, costs that will be passed on to these small business plans and employees.

- Many small businesses cannot offer 401(k) or similar "traditional" retirement plans because of administrative complexity, costs, or eligibility requirements, and instead offer simplified, basic retirement plans built around IRAs.

- SEP IRAs and SIMPLE IRAs are popular choices that are easy and inexpensive to set up and operate. Studies estimate that more than 9 million households own IRAs as a result of these small employer-provided retirement plans.

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Executive Summary

Stretching its current regulatory authority over employer-provided retirement plans, the U.S. Department of Labor (DOL) proposed in April a new regulatory package that would put DOL in charge of financial advice provided to all Individual Retirement Accounts (IRAs) as well as to all private-sector, employer-provided retirement plans. This regulatory expansion would change the rules governing how financial advice is provided to roughly $15 trillion in retirement savings, putting DOL in charge. Unsurprisingly, this kind of sweeping change would result in a lot of unintended consequences.

The DOL is expanding the definition of fiduciary investment advice under a federal law known as the Employee Retirement Income Security Act (ERISA). The result would be that many traditional forms of compensation, such as commissions that vary from one investment to another, for financial advisors could become illegal under special provisions in that law called "prohibited transactions." A number of aspects of the proposal appear unworkable in actual practice, and would negatively impact how advisors assist small businesses in providing retirement benefits for their employees. In particular, the change would impact two of the most popular retirement savings vehicles for small businesses: Simplified Employee Pension IRAs (SEP IRAs) and Savings Incentive Match Plan for Employees IRAs (SIMPLE IRAs).

The proposal would adopt a broad definition of fiduciary "investment advice" encompassing "sales" communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL's new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her. Consequently, small businesses may find it even harder to offer retirement plans than they do today.

Small businesses make up 99% of all U.S. employers, and account for 63% of new private-sector jobs, as well as almost half of all private-sector employment and output.[1] Like their large employer counterparts, small business entrepreneurs and the millions of workers they employ need retirement savings opportunities. But unlike large employers, many small businesses may not be able to offer a 401(k) or similar "traditional" retirement plan due to cost, administrative complexity, or eligibility rules. Instead, many of these small businesses rely on simplified retirement plans to cover their owners and employees.

Two of the most attractive and popular retirement savings solutions used by small businesses are SEP IRAs and SIMPLE IRAs. SEP IRAs and SIMPLE IRAs are easy and inexpensive to set up, and do not impose ongoing administrative or reporting requirements on employers, allowing

[1] *See* U.S. Small Business Administration, Office of Advocacy, "Frequently Asked Questions," March 2014, *available at* https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.

their focus to remain on growing their businesses. These special IRAs have been very successful in helping small business workers save for retirement—nearly 10% of all current IRAs come from SEP/SIMPLE-type plans.[2] As of the end of 2014, there were approximately $472 billion of retirement savings in these types of IRA plans.[3] Another study of IRA data concluded that more than 9 million U.S. households owned employer-sponsored IRAs like SEP and SIMPLE IRAs.[4]

More complex regulations mean more hurdles and compliance costs, and a greater likelihood of lawsuits. Main Street advisors will have to review how they do business, and likely will decrease services, increase costs, or both. Small business SEP IRA and SIMPLE IRA arrangements that currently depend on these advisors for affordable assistance are likely to disproportionately bear the costs of excessive regulation—their small scale means they are more expensive to serve. The U.S. Chamber believes that DOL's proposed regulations risk hurting the very small businesses and workers they are intended to protect.

[2] "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010–2013: The EBRI IRA Database," Craig Copeland, EBRI Issue Brief #414, May 2015.

[3] *See* Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2014," March 2015, *available at* www.ici.org/info/ret_14_q4_data.xls.

[4] *See* Investment Company Institute, "How Many Households Own IRAs," based on year-end 2012 data, *available at* http://www.ici.org/faqs/faq/faqs_iras.

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Introduction

This DOL regulatory expansion would change the rules governing how financial advice is provided to roughly $15 trillion in retirement savings. Unsurprisingly, this kind of sweeping change would result in significant unintended consequences. One such unintended consequence is that small businesses may find it even harder to offer retirement plans than they do today, and some may stop offering employer-sponsored IRA plans to employees. SEP and SIMPLE IRAs are basic retirement plans that allow small businesses to offer retirement savings opportunities to their employees, and are set up with the help of financial professionals that they trust. DOL, however, thinks these Main Street financial advisors need a new set of complex rules and regulations to prevent potential conflicts of interest.

The DOL proposal would adopt a broad definition of fiduciary "investment advice" encompassing "sales" communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL's new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her.

The proposed standards for defining what would or would not be fiduciary investment advice are highly subjective and would be difficult to observe in practice. Even well-meaning advisors who do not intend to provide specific, individualized investment advice may inadvertently "step in" to fiduciary status, triggering potential prohibited transactions and greater legal liability. To compensate for the significant liability they could face, these advisors, and the financial institutions they work for, would likely have to include an additional risk premium in the fees they charge to clients.

This expanded fiduciary definition can also make it hard for advisors to recommend SEP and SIMPLE IRA investments that use certain proprietary investment products. For example, an insurance agent advising a SEP or SIMPLE might not be able to discuss some of the investments offered by the insurance company for which the agent works, regardless of their performance or suitability for the individual.

In order to comply with the proposed regulatory package, many advisors and their related financial institutions would have to change how their products and services are structured, and how the retirement plans and IRA accounts are charged fees. If finalized in its current form, the proposed rule would very likely increase the costs associated with SEP IRAs and SIMPLE IRAs, and would make it more difficult for retirement savers to receive meaningful assistance, such as choosing appropriate asset allocations, within their accounts. Some Main Street advisors may choose to exit the SEP and SIMPLE IRA marketplace in light of the costs and risks of compliance with the new rule.

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Benefits of SEP and SIMPLE IRAs

SEP and SIMPLE IRAs provide benefits for more than 9 million households because they are simpler for employers to offer than 401(k)s, but give employees more generous benefits than traditional IRAs not offered through employers. Though SEP and SIMPLE IRAs are built around IRAs, they are plans provided by the employer, and the tax laws permit more tax-preferred contributions than are allowed in a non-employer provided IRA, which limits contributions to $5,500 in 2015 ($6,500 for individuals 50 and older). SEP and SIMPLE IRAs are different from one another, however, and one may be better for a particular small business over another.

SEPs and SIMPLE IRAs are simplified plans presenting less administrative burden than 401(k) and other plans. For example, unlike many other plans, the assets and investments in SEP and SIMPLE IRAs are held within each participating employee's IRA account rather than in a common trust account. This reduces the record keeping at the plan level. Likewise, unlike other plans, there is no annual Form 5500 filing requirement for a SEP IRA or SIMPLE IRA, a significant cost savings in and of itself. Perhaps the most significant differences relate to investments. Under a traditional 401(k) or other defined contribution plan, the employer (or its plan committee, etc.) must evaluate, select, and monitor each of the core investment options offered to participants. There has been a significant uptick in lawsuits against 401(k) plan sponsors in recent years, often alleging excessive fees and expenses associated with selected investments.

For a SEP IRA or SIMPLE IRA, the investment funds offered are not individually selected by the employer—rather, they generally constitute a broad range of alternatives offered by the vendor through its IRA platform. The employer does not generally have involvement with monitoring the options or instructing the IRA vendor to add, replace, or discontinue the alternatives made available. Employers considering a SEP IRA or SIMPLE IRA that select the IRA vendor should review potential providers and make a prudent determination that the vendor selected offers a suitable product at a commercially reasonable price. Likewise, DOL guidance indicates that employers should periodically monitor the vendors (that is, the IRA trustees) to ensure they are doing their jobs and not charging unreasonable fees.[5] But, in comparison with a traditional qualified plan, the employer's fiduciary obligations as to a SEP IRA or SIMPLE IRA are very limited in scope. Not only does this limit the fiduciary liability of small business owners, but it also allows them to focus more of their time in managing and growing their business while increasing jobs.

Of course, the significant reductions in cost and administrative burdens also mean that SEP IRAs and SIMPLE IRAs are less flexible than traditional retirement plans. Employers have less ability to limit eligibility for participation, to vary contribution amounts for different employee groups,

[5] *See* DOL, SEP Retirement Plan for Small Businesses, "Monitoring the Trustee," *available at* http://www.dol.gov/ebsa/publications/SEPPlans.html; *and* SIMPLE IRA Plans for Small Businesses, "Monitoring the Trustee," *available at* http://www.dol.gov/ebsa/publications/simple.html.

and to offer certain other features than they would under a traditional qualified plan. However, this loss of flexibility is often a blessing in disguise for small businesses—with the flexibility of a traditional qualified plan comes complex nondiscrimination testing, numerous participant disclosures, government reporting, vendor oversight, and day-to-day administrative tasks.

SEP IRAs

SEP IRAs provide benefits similar to qualified profit sharing plans, in that contributions are funded by the employer. Contributions are limited to 25% of each eligible employee's compensation, and the same percentage must be applied for each eligible employee. Annual contributions are also capped at $53,000 (for 2015) and cannot be based on compensation exceeding $265,000 (also for 2015), which are the same limits that apply to qualified defined contribution plans. Employees are not allowed to contribute to a SEP IRA, but they benefit from the employer contributions, which are not taxed to the employee until the funds are withdrawn at retirement. As such, SEP IRAs are mostly utilized by sole practitioners or employers with a very small number of employees.

A SEP IRA can be established by executing Form 5305-SEP, issued by the Internal Revenue Service (IRS), or another prototype or individually designed plan document. All contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs.

Once a SEP IRA is established, the employer may, but is not required to, make contributions each year. Each eligible employee must be provided with certain information about the SEP IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who (i) receive $600 or more in compensation during the year (for 2015), (ii) are at least 21 years of age, and (iii) have worked for the employer during three of the previous five years. The employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

SIMPLE IRAs

SIMPLE IRAs are an option for employers that do not maintain other retirement plans, and have 100 or fewer employees. If the business grows, a two-year grace period is allowed in most cases after the 100-employee threshold is exceeded to transition to a 401(k) plan or some other retirement plan. SIMPLE IRAs are more similar to 401(k)s—eligible employees can make elective deferral contributions from their own pay, subject to a $12,500 annual limit (for 2015, plus up to $3,000 in catch-up deferrals for employees aged 50 and over), and employers make either (i) a dollar-for-dollar matching contribution on elective deferrals up to 3%, or (ii) a flat (nonmatching) contribution for all eligible employees equal to 2% of compensation. Again, contributions cannot be based on compensation exceeding $265,000.

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A SIMPLE IRA can be established by executing IRS Form 5304-SIMPLE or 5305-SIMPLE (depending on whether each employee can select his or her own IRA institution, or if there is a designated financial institution for the entire arrangement), or another prototype or individually designed plan document. Again, all contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs. Once a SIMPLE IRA is established, each eligible employee must be provided with certain information about the SIMPLE IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who are expected to earn at least $5,000 in compensation during the year, and have earned $5,000 or more during any previous two years. Again, the employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

Small Businesses Are Most Harmed by the DOL Proposal

The DOL proposal expands the universe of financial advisors considered to be fiduciaries. The effect of being a fiduciary is that many traditional compensation arrangements, such as commissions that vary from investment to investment, utilized by advisors to SEP and SIMPLE IRAs would no longer be permitted. Unfortunately, the proposal puts small business retirement plans at a further disadvantage relative to large employer plans because they are not treated the same.

Small Business Advisors Unfairly Excluded From the Seller's Carve Out

The DOL proposal "carves out" large plan advisors from fiduciary status. If a plan has 100 or more participants, or $100 million or more in plan assets, the advisor to that large plan does not have to be a fiduciary, while an advisor to a small plan does. Because an advisor to a small plan is not carved out of the rule, the advisor who is trying to market retirement saving vehicles to a small plan is considered to be providing investment advice and must determine how to comply

Realizing the Impact

Consider Kathleen's Wedding Kakes, a hypothetical small business in Tucson, Arizona, that employs about eight people in its shop, bakery, and delivery service. Like most small business owners, the founder, Kathleen Carver, wanted to help her employees save for their retirements, but because her business was so small, she could not afford to offer a traditional 401(k).

Instead, she established SEP IRAs for each of her employees, and contributes matching funds each month. When these new rules go into effect, the cost of offering these plans could significantly increase. Her financial advisor says he may have to change his whole business model, and that he may not be able to afford to spend the time it takes to help her and her employees with their small account balances unless he charges higher, up-front fees. If this happens, Kathleen will have to reassess her ability to offer this important benefit to her employees.

with the rule. This advisor must either now provide advice for a level fee or, if the advisor has variable compensation, he or she must comply with the many conditions of an applicable prohibited transaction exemption (an exemption that may still limit fee variation). Advisors to large plans are not burdened with these additional hurdles under the carve out. Due to these additional burdens, advisors to small plans are likely to incur additional costs, which will be passed on to the plan. Further, some advisors to small plans may determine that the small-scale of such plans means the expense and risk of changing business models and fee structures is not justified, and may no longer offer their services to small plans.

It does not make sense that small business plans should have to absorb costs that large plans do not simply because of regulatory fiat. While DOL may intend this as "extra protection" for small plans, it really represents "extra cost." SEP IRAs and SIMPLE IRAs are popular among small businesses because they are cheaper and easier to offer and operate than 401(k) plans; therefore, imposing additional costs would make SEP and SIMPLE IRAs less attractive to small business owners, making it harder to offer plans to their employees.

The Proposal Will Increase the Cost of Providing Services to Small Businesses

Because advisors to small businesses are not carved out of the fiduciary definition, they must change their fee arrangements, or qualify for a special rule called an "exemption" in order to provide services on the same terms as before. However, the new exemption proposed by the DOL may not apply to small business plans. It does apply to individual owners of IRAs, but it is not clear whether this exemption is available for SEP and SIMPLE IRAs while they are being offered by the employer. Further, even if it does apply, the new exemption—called the "Best Interest Contract Exemption"—would itself substantially increase costs for advisors due to its many conditions and requirements.

The reason the DOL regulatory package causes such significant change is that a fiduciary investment advisor under ERISA generally has engaged in a prohibited transaction if the advisor recommends investments that either pay the advisor a different amount than other investments, or that are offered by affiliates (for example, the advisor is connected with the insurance company that offers the investment). There are certain exceptions to these rules, called "prohibited transaction exemptions," but as the DOL has proposed the new rules, the exemptions generally won't help Main Street financial advisors who are working with small businesses to set up plans. Therefore, it may be illegal for those advisors to get commissions or to recommend certain investments.

For example, it may not be possible for a bank official to recommend that an IRA invest in the bank's own certificates of deposit under some circumstances. Or if a financial institution provided SEP IRA or SIMPLE IRA marketing materials to a prospective small business client, and those materials described a sample allocation that included some of the institution's own investment products, the marketing materials could be viewed as prohibited advice.

One way advisors might try to comply is by charging a flat fee for their SEP or SIMPLE IRA services. However, many IRA vendors prefer not to charge a direct fee to account holders, and many account holders prefer not to pay flat fees, especially in small accounts where a flat fee may be a significant portion of the assets. Logically, a vendor must generate a certain amount of revenue from servicing a SEP IRA or SIMPLE IRA account to generate some profit from it, or it will not provide the service. If advisors and vendors change to a flat fee model, they may actually charge more than before to account for the risk and expense associated with changing their method of doing business. This potential loss of low-cost investment assistance was one of the reasons why the DOL's previous proposal to redefine fiduciary investment advice several years ago—a proposal that was ultimately withdrawn—raised objections from many within Congress.[6] It is important to note, however, that some advisors may already be compensated in a manner consistent with the proposed DOL requirements, though this is less common in IRAs and small 401(k) plans.

How to Make a Difference

The public comment period for this proposal is open until July 20, 2015. After the comment period, there will also be public hearings at DOL. After all of the comments and hearings are concluded, DOL will have to review the comments and take them into account in writing a final rule. In all likelihood, this process will not be complete until sometime in 2016, and DOL proposed an eight-month transition period before the final rule would take effect.

To be most effective, the DOL proposal needs to strike a proper balance between protecting the interests of retirement investors and ensuring they have access to reasonably priced investment services. To accomplish this, advisors and financial institutions need to be provided with practical and clearly defined boundaries as to what is or is not fiduciary investment advice, as well as with commercially realistic and reliable standards.

Under the current proposal, Main Street advisors are very concerned that there may be no reasonable avenue to communicate meaningfully with individual and small plan investors (including SEP IRAs and SIMPLE IRAs) about matters related to investments without incurring potentially significant new costs and legal risks.

[6] *See, e.g.* Letter from members of the Congressional Black Caucus serving on the House Financial Services Committee to then-Acting Labor Secretary Seth Harris dated March 15, 2013, warning that the "if the re-proposal reflects the Department's initial fiduciary proposal it could disparately impact retirement savers and investment representatives in the African American community…We are particularly concerned about the effects these regulations will have on savers in [IRAs]. If brokers who serve these accounts are subject to ERISA's strict prohibitions on third-party compensation, they may choose to exit the market…[i]f that occurs, it could cause IRA services to be unattainable by many retirement savers in the African American community."

U.S. CHAMBER OF COMMERCE

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AARP
Real Possibilities

March 13, 2015

Dear Representative:

On behalf of AARP's 38 million members, I am writing to express opposition to H.R. 1090, the Retail Investor Protection Act. This legislation would erect new barriers that would delay or halt efforts by the Department of Labor (DOL) and the Securities and Exchange Commission (SEC) to adopt rules requiring all financial advisers to act in the best interests of their clients when providing investment advice. By impeding these efforts, H.R. 1090 would prevent the regulatory agencies from updating rules needed to protect consumers from financial professionals who could continue to take advantage of loopholes in the law to profit at their clients' expense.

AARP believes that hard working Americans who save and invest for a secure and independent retirement should be able to trust that the investment advice they receive is in their best interest, no matter who provides the advice. By delaying the DOL fiduciary rule for retirement savings until the SEC has completed a rule, and by imposing new bureaucratic hurdles on the SEC before a rule can be finalized, H.R. 1090 would halt progress in strengthening crucial investor protections.

AARP is encouraged that the DOL and SEC are working to update rules, close loopholes, increase accountability, and strengthen the standards that apply when financial professionals provide investment advice to their clients. It is worth noting that, whether in the context of retirement savings or investing for other purposes, most American consumers assume that financial professionals provide investment advice based on the best interests of the person they are advising. But that is not always the case. Unless an advisor has a "fiduciary duty" – a legal requirement to act in the consumer's best interest – he or she could be providing advice that is more profitable for their own financial prospects than serving the consumer's best interests. There are a substantial number of investment advisors who act in the interests of their clients. Many investment advisors today are required to avoid conflicts and provide quality investment advice that is in the best interests of their clients. Our goal is to ensure that everyone who is providing retirement advice to seniors – and all Americans – meet that same standard.

The DOL and SEC each have an important and unique role when it comes to protecting the quality of advice that financial professionals provide to investors. Under the Employee Retirement Income Security Act (ERISA), DOL has exclusive authority over retirement accounts, including traditional pension plans and defined contribution plans such as 401(k)s, and shared authority over Individual Retirement Accounts (IRAs). Under the securities laws, the SEC has exclusive authority over private securities accounts and shared authority over IRAs. The SEC's authority is limited to recommendations regarding securities, while the DOL's is not. Neither agency currently requires all professionals who provide advice to make recommendations that serve their customers' best interests. Given dramatic changes in our retirement and financial markets over the past 40 years, AARP supports efforts by both agencies to provide comprehensive protections governing the provision of investment advice.

The Department of Labor recently took an important step forward in the process by submitting its rule proposal to OMB for interagency review. AARP welcomed this important action as it puts

retirement savers one step closer to getting financial advice that puts them and their financial futures first. Indeed, AARP has been fighting for this common sense consumer regulation for over five years. Middle income Americans who need to make every dollar count simply cannot afford investment advice that can cost them thousands of dollars or more over time.

The SEC, although not as far along in the process as DOL, also is considering updating its regulations with respect to investment advice, so as to more fully address the issue of brokers who market themselves as trusted "financial advisers" but act and are regulated as salespeople, without any legal obligation to put the interests of their clients first. As a result of this regulatory loophole, some "financial advisers" are free to recommend investment products with high costs and sub-par performance, or that expose the investor to unnecessary risks.

AARP maintains that both the SEC and DOL should be allowed to address these issues through the standard regulatory process. H.R. 1090 would impede that process by imposing new burdens on the SEC that would delay fiduciary rulemaking at that agency. Worse yet, the legislation ties DOL to the SEC process, effectively preventing the DOL's conflict of interest rulemaking from moving forward.

AARP believes that an individual's retirement savings are too important to be put at risk by outdated rules that allow some financial advisers to act in their own personal financial interests rather than in the customer's best interest. AARP encourages you to stand with your constituents – who are saving for retirement and deserve to have the best financial advice for their future– by allowing the Department of Labor's rulemaking process to move forward. As such, AARP opposes H.R. 1090.

If you have any questions or need additional information, please feel free to call me, or have your staff contact Mary Wallace on our Government Affairs staff at 202-434-3954.

Sincerely,

Nancy A. LeaMond
Executive Vice President
State and National Group

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

815 Sixteenth Street, N.W. • Washington, D.C. 20006 • (202) 637-5000 • www.aflcio.org

LEGISLATIVE**ALERT**

EXECUTIVE COUNCIL

RICHARD L. TRUMKA
PRESIDENT

ELIZABETH H. SHULER
SECRETARY-TREASURER

TEFERE GEBRE
EXECUTIVE VICE PRESIDENT

April 15, 2015

Dear Representative,

On behalf of the more than 13 million people represented by the AFL-CIO and our 57 member unions, I urge you to oppose H.R. 1090, the misnamed "Retail Investor Protection Act," when comes before the Financial Services Committee for mark-up later this month. We view a vote for this bill as a vote to obstruct important protections for vulnerable investors and weaken workers' retirement security.

The committee will consider this legislation just as the Department of Labor (DOL) releases its long-awaited rule to protect workers and retirees from harmful investment advice by requiring retirement investment advisors to abide by a "fiduciary" standard -- putting their client's best interests before their own profits.

H.R. 1090 would delay and possibly thwart the DOL from promulgating these critically needed protections on retirement savings. At the same time, it would throw-up numerous roadblocks to efforts by the Security and Exchange Commission (SEC) to issue a rule raising the standard of conduct that applies to brokers when they provide advice to retail investors. Make no mistake: the intent behind this bill is to delay SEC rule and thereby also block DOL from carrying out its statutorily required responsibilities.

The DOL fiduciary protections are long overdue. With the shift from defined benefit plans to self-directed 401(k)s and individual retirement accounts, workers are increasingly on their own, bearing all the responsibility and risks for building adequate retirement savings. Faced with complex choices, they often turn to professional advisors for help, and they assume the investment advice they receive is in their best interest. But DOL's current investment advice regulations -- the basic rules that protect workers' retirement savings from deceptive and harmful practices -- were written in 1975 and haven't kept pace with the dramatic changes in the retirement landscape. Outdated rules allow financial professionals to legally put their own interests ahead of their clients. Too often, today's workers are steered into inappropriate or sub-standard investment products that are lucrative for the advisor but cost the worker precious retirement savings.

The costs of conflicted investment advice are real and they are significant. According to a recent report from the White House Council of Economic Advisors, American savers lose an astounding $17 billion per year as a result of retirement investment advice that does not put their best interest first.

H.R. 1090 would prevent DOL from moving forward with its rule to protect retirement savings until after the SEC has finalized new rules covering the duties of brokers to their customers. Having prevented any DOL action prior to SEC rulemaking, HR 1090 would then add about a dozen new analytic and reporting requirements that must be fulfilled before any SEC action to impose fiduciary duty on brokers. These requirements would not meaningfully contribute to the benefit of investors but would delay rulemaking and encourage additional litigation.

It is simply wrong to say that the activities of these two agencies would result in conflicted standards. The DOL has engaged in thorough deliberative rulemaking process, conducting extensive economic analysis and consulting industry groups and stakeholders. Additionally, DOL has worked in close coordination with the SEC throughout the draft rulemaking process; Secretary Perez has consulted with SEC Chairman Mary Joe White numerous times, agency staff have been in touch consistently and SEC has provided technical assistance to DOL. The DOL has statutory jurisdiction over retirement investment advice and has coordinated closely with the SEC to ensure that its rule does not conflict with any rule the SEC may eventually adopt. There is no justification for Congress to insert itself into this regulatory process.

We urge you to oppose H.R. 1090, an ill-disguised attempt to thwart two important rulemakings, the effect of which will be to allow the continuation of financial practices that harm American workers and undermine their retirement security.

Sincerely,

William Samuel, Director
Government Affairs Department

WS/GD/lkr

Statement of Shaun O'Brien
Assistant Policy Director for Health and Retirement
American Federation of Labor and
Congress of Industrial Organizations

House Financial Services Committee
Subcommittees on Government Sponsored Enterprises and
Oversight and Investigations

"Preserving Retirement Security and Investment Choices for All Americans"

September 9, 2015

I am the Assistant Policy Director for Health and Retirement at the AFL-CIO, and I submit this statement on behalf of our 56 national and international affiliated unions and the 12.5 million working people they collectively represent.

Protecting and enhancing the retirement security of America's workers and retirees is a top priority for the AFL-CIO. We participated in the years-long legislative debates that culminated in the retirement investment advice provisions enacted as part of the Pension Protection Act of 2006. And, from the very beginning, we have been engaged in the extended rulemaking process for the Department of Labor's proposed investment advice rule that is the subject of this hearing.

All of America's workers, but especially those who are union members, have a lot at stake in the private-sector pension and retirement savings system. Consider the following statistics:

- More than four-in-five (83%) private-sector union workers participate in workplace retirement plans.[1]
- While most are covered by defined benefit pensions (66%), more than two-in-five (45%) participate in defined contribution plans.[2]
- More than one-in-four dollars in ERISA-covered retirement plans (27%)—totaling $1.9 trillion in assets—are in collectively bargained plans.[3]

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[1] U.S. Dept. of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2014, Bulletin 2779* (Sept. 2014) t. 2 (private industry workers), *available at* http://www.bls.gov/ncs/ebs/benefits/2014/ebbl0055.pdf.

[2] U.S. Dept. of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2014, Bulletin 2779* (Sept. 2014) t. 2 (private industry workers), *available at* http://www.bls.gov/ncs/ebs/benefits/2014/ebbl0055.pdf.

[3] *Calculated from* U.S. Dept. of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2012 Form 5500 Annual Reports* (Jan. 2015 v. 1.2) t. A6, *available at* http://www.dol.gov/ebsa/pdf/2012pensionplanbulletin.pdf.

- Thousands of union members serve as fiduciary trustees jointly responsible with management-appointed representatives for administering retirement plans and overseeing the investment of retirement plan assets.
- Union workers and retirees from both the private and public sectors have retirement money invested through Individual Retirement Accounts ("IRAs"). Like non-union workers and retirees, many of them transfer money from workplace retirement plans into IRAs when they leave a job.

The AFL-CIO strongly supports DoL's proposed package of regulatory changes designed to ensure that retirement investors who seek out investment advice receive advice that is in their best interest and not tainted by financial conflicts of interest. This package includes two major components: (1) a proposed updated definition of "fiduciary" by reason of having given "investment advice;" and (2) several proposed new and amended prohibited transaction exemptions laying out the conditions under which a conflicted fiduciary adviser may provide advice.

The proposed rule would remove several significant loopholes in the existing rule promulgated by DoL and Treasury in 1975 or adopted by DoL in subsequent interpretive guidance. In our view, the proposed definition would better align the regulatory definition of advice with both the full scope of the statutory definition and retirement investors' reasonable expectations.

Through the proposed exemptions, DoL is exercising its authority granted by Congress to issue administrative prohibited transaction exemptions ("PTEs") from the ban on a fiduciary engaging in certain transactions regarding the assets of a plan or IRA if the fiduciary has a conflict of interest. In most cases, these PTEs are in addition to, not replacements for, other existing statutory and administrative exemptions and guidance regarding the provision of advice.

We are deeply concerned that many financial institutions currently choose to pay financial advisers in ways that incentivize them to provide investment advice that is not in the best interests of their Retirement Investor clients. DoL's Regulatory Impact Analysis clearly demonstrates the harm from financial conflicts in the form of higher-than-appropriate fees and expenses and lower returns. That analysis confirms that differential compensation levels that are unrelated to any neutral factor are likely to encourage advice that is not in the best interests of Retirement Investors.

Left unaddressed—or if reforms are delayed—these conflicts will inflict greater and greater harm on workers and retirees, especially as they rely increasingly on individual retirement accounts to supplement Social Security. Further, these conflicts will erode Americans' confidence in the financial markets and reinforce the public's perception that, in the halls of government, Wall Street's interests trump those of Main Street.

DoL's proposal to adopt a common-sense definition of fiduciary investment advice is an essential step in restoring confidence in the private retirement system. It ensures that this system in fact serves the best interests of the retirement investors for whom it was created.

We are mindful that Congress also gave DoL administrative authority to grant exemptions from the prohibited transaction rules so long as the Secretary of Labor finds an exemption to be administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of the participants and beneficiaries and IRA owners.[4] In laying out these conditions, Congress appropriately set a high bar. In our view, such a finding can be made with respect to the provision of conflicted investment advice only if an exemption is conditioned on compliance with substantive protections that go well beyond disclosure of financial conflicts, in fact mitigate harmful conflicts of interest, and require advisers and financial institutions to commit to an appropriate duty of care to their Retirement Investor clients.

High-quality investment advice provided solely in the interest of retirement investors and not biased by financial conflicts of interest is critical to ensuring that the private pension and retirement savings system actually meets the needs of the workers and retirees it was created to serve. We believe the Best Interest Contract Exemption ("BICE") as proposed will lead to retirement investors receiving advice that is in their best interest when a fiduciary adviser has a financial conflict of interest. Further, we believe the Secretary may reasonably find and should find that the BICE as proposed satisfies the statutory requirements for granting a prohibited transaction exemption.

Critics of the Department's proposal have charged that reforms that address harmful conflicts of interest will increase costs for Retirement Investors. Such assertions are fundamentally misleading. Retirement Investors are paying huge costs for conflicted advice; the costs are just hidden. As DoL establishes in its Regulatory Impact Analysis, IRA holders receiving conflicted advice can expect their investments to underperform by an annual average of 100 basis points. In the mutual fund segment alone, this conflict-driven underperformance could cost IRA investors more than $210 billion over the next 10 years and nearly $500 billion over the next 20 years.[5] Bringing these kinds of costs out in the open will create genuine choice and help prevent overpaying.

We strongly support extending the scope of the regulatory definition to include all distribution recommendations. For many working people, deciding whether and how to take a distribution and what to do with it are once-in-a-lifetime decisions. The choices made at this juncture can have significant, even life-altering, consequences—with no do-overs possible in many cases.

A recommendation whether to take a distribution from a plan or to take one form of distribution over another is, in fact, a recommendation about the value of the plan's investments. This is true whether comparing a lump sum to continued investment through a 401(k)'s investment options—comparing a lump sum to an annuity in a pension plan—OR comparing a qualified joint and survivor annuity to a single life annuity.

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[4]ERISA § 408(a). Internal Revenue Code § 4975(c)(2).

[5] U.S. Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis* (Apr. 21, 2015) p. 7, *available at* http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf. ("*Regulatory Impact Analysis*")

A plan representative shared the following experience with me: A pension plan participant and his spouse were advised by a financial adviser (who was not otherwise a fiduciary to the plan) to reject the default form of benefit—the qualified joint and survivor annuity required for married participants under federal law—and elect a single life annuity. The adviser recommended that they do this and invest the excess of the single-life monthly benefit check over the joint and survivor benefit.

In this particular instance, the advice proved to be particularly costly to the spouse. When the participant rejected the survivor annuity, with the spouse's consent, the spouse lost her right to valuable retiree health benefits. The adviser either failed to consider this consequence or disregarded it. The adviser, however, was insulated from accountability under the Department's current guidance even though the adviser clearly was recommending a personalized course of action about the annuity to select and the investment of a portion of the monthly annuity check.

With respect to plan sponsor fiduciaries, we believe DoL has struck the right balance between the needs of large and small plan sponsors, restricting the BICE to advice provided to a plan sponsor of a non-participant-directed plan with fewer than 100 participants.[6] In our experience, large plan sponsors are sophisticated users of professional advisers with ready access to conflict-free advice and therefore do not need access to the BICE. Further, the sales exclusion from the definition of fiduciary investment advice included in the Proposed Rule[7] appropriately addresses circumstances in which a conflicted adviser may make recommendations regarding the investment of a large plan's assets to an independent plan fiduciary with financial expertise without the adviser being considered a fiduciary.

We support the proposed definition of "asset"[8] to which the provision of conflicted investment advice would be limited under the BICE. The broad list of investment products enumerated in the definition is more than adequate to enable a conflicted adviser to make recommendations that serve the best interests of small-plan and individual retirement investors, while limiting the use of investment products that provide greater opportunities for conflicted advisers to provide advice that violates the BICE's contractual standards of conduct. Conflicted advice could still be provided with respect to other permitted investment vehicles, such as mutual funds, that invest in otherwise off-list products.

It is important to note that the proposed definition of "asset" applies only in determining whether a transaction is covered under the BICE. The definition does not otherwise limit the investment products in which a plan, participant or beneficiary account, or IRA can be invested. Although off-list products not readily available through other permitted investment vehicles likely will be of interest to only a small segment of Retirement Investors, a Retirement Investor may still choose to invest in such products. Further, a Retirement Investor will continue to have access to advice on off-list investment products by seeking recommendations from conflict-free advisers or advisers who satisfy another exemption. Retirement Investors who seek out more complex,

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[6]Proposed Section I(b) at 80 Fed. Reg. 21984.
[7]Proposed Section 2510.3-21(b)(i) at 80 Fed. Reg. 21957.
[8]Proposed Section VIII(c) at 80 Fed. Reg. 21987.

less transparent, or more illiquid investments are likely in a better position to acquire advice outside the BICE structure.

We also support the requirement that advisers and financial institutions enter into a written contract with Retirement Investors before advice is provided,[9] as we believe it will result in substantial benefits to Retirement Investors by clearly defining the terms of their relationship with financial advisers, regardless of the title an adviser may use for marketing purposes or how she is otherwise regulated under other federal or state laws. We note that research shows that individual investors typically express confusion about the many different titles used by financial advisers and the duties owed by those advisers and financial institutions to their clients. The BICE-required contract will address this confusion and any ambiguities about the legal responsibilities of the adviser and the financial institution to the Retirement Investor.

Clearly defining an adviser's and financial institution's status and commitment to specified standards of conduct are essential to ensuring the proposed exemption is in the interests of the plan, participants and beneficiaries, and IRA owners and protective of the rights of participants and beneficiaries and IRA owners. The BICE-required contract will create clear standards that apply across all transactions covered by the BICE, with no distinction between those involving the assets of plans covered by Title I of ERISA and those involving the assets of IRAs. Its clear statement that the adviser and financial institution are fiduciaries with respect to any advice being given will avoid unnecessary disputes about their status. The required warranties, discussed in more detail below, will ensure that harmful conflicts of interest that encourage violation of the standards of conduct are addressed affirmatively through financial institution policies and procedures and actual changes in compensation practices.

The BICE contract is essential to protecting the rights of Retirement Investors because it enables a Retirement Investor to enforce the best interest standard using existing contract law. This is particularly important for IRA owners who do not have an individual statutory right of action and otherwise would have to rely on the IRS to protect their interests and enforce the terms of an exemption.

We support the required contractual warranties by the adviser and financial institution relating to: (1) compliance with all applicable and related state and federal laws, (2) adoption of written policies and procedures reasonably designed to mitigate the impact of material conflicts of interests and ensure adherence to the BICE impartial conduct standards, (3) identification of material conflicts of interest and adoption of measures to prevent those material conflicts of interest from causing violations of the impartial conduct standards, and (4) absence of use by the financial institution (including any affiliate or related entity) of actions or incentives that tend to encourage recommendations that are not in the Retirement Investor's best interest.[10]

In our view, this broad approach provides sufficient flexibility to advisers and financial institutions to continue, adapt, and develop a range of business models for delivering investment advice while protecting and promoting Retirement Investors' rights and interests. We are aware

[9] Section II at 80 Fed. Reg. 21984-21985.
[10] Section II (d) at 80 Fed. Reg. 21984.

of complaints by financial institution representatives that financial institutions may have to change how they pay advisers and how Retirement Investors pay for advice under the approach proposed by DoL. That, of course, is the point. As DoL's Regulatory Impact Analysis amply demonstrates, some financial institution's existing compensation structures encourage recommendations that harm Retirement Investors. We expect the gains to Retirement Investors will significantly outweigh any costs needed to implement these changes.

We are aware of calls by some financial industry representatives to replace the BICE with an exemption that pairs a best interest standard of care merely with disclosure of an adviser's conflicts of interest. Such an approach is neither in the interests of retirement investors nor protective of the rights of participants and beneficiaries of the plan or IRA owners. Disclosure alone will not mitigate conflicts of interest in investment advice. Even if we could be certain that such disclosure would be read and it could be made simple and clear—assumptions we do not ake for granted—it might, in fact, be not only ineffective, but also harmful. DoL's Regulatory Impact Analysis cites several academic studies demonstrating the ways in which disclosure alone is an inadequate remedy with unintended consequences, one of which is that advice recipients might interpret the disclosure of conflicts as a sign of honesty, rather than a red flag.[11] Given this, the Secretary would not be able to make the findings needed to issue such an exemption that does not include meaningful requirements that financial conflicts be mitigated.

We support conditioning the exemption on the financial institution offering and the adviser making available to the Retirement Investor a range of investments that is broad enough for the adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the best interests of the Retirement Investor in light of its specific investment objectives, risk tolerance, and specific financial objectives.[12]

When a financial institution limits the assets made available, it should be able to make a general finding with respect to its current and potential Retirement Investor clients that it offers a sufficient range so long as it makes available investments covering all asset classes reasonably necessary to serve the best interests of any reasonably likely client. A financial institution that does not satisfy this broad standard, but would like to take advantage of the BICE, should be required to make this determination on an investor-by-investor basis. For any institution that limits the assets made available, we support requiring written pre-advice disclosure of the limitations that have in fact been imposed. We agree that the notice should not be permitted to use vague language that merely suggests that investment recommendations "may" be limited.

In sum, financial professionals who are paid by retirement investors to make investment recommendations should be considered fiduciaries. Tricks and traps and loopholes in the current fiduciary definition benefit financial advisers and financial institutions, but harm retirement investors. The nearly five years since this rulemaking process began have added up to tens of

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[11] U.S. Dept. of Labor, Employee Benefits Security Administration, Fiduciary Investment Advice Regulatory Impact Analysis (Apr. 12. 2015) pp. 194-197, *available at* http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[12] Proposed Section IV at 80 Fed. Reg. 21985-21986.

billions of dollars in excessive fees and expenses and investment under-performance resulting from conflicted advice—all paid for by workers and retirees. It's time to stop the losses. The Department needs to finish its job.

AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

March 10, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 1090, the "Retail Investor Protection Act".[1] This misnamed legislation in fact eliminates needed protections for retail investors. HR 1090 would significantly delay and possibly prevent the Department of Labor from proposing a rule addressing flaws in protections for retirement savings, protections that have not been updated for some forty years. It would also add numerous roadblocks to efforts of the Securities and Exchange Commission to raise the standard of conduct that applies to brokers when they give advice to retail investors.

Tens of millions of average American families rely on financial professionals for investment advice that will determine whether they can afford to retire or fund their children's college education. But many financial professionals are not subject to a fiduciary duty to put their customers' best interests first. Financial professionals not covered by a fiduciary duty are legally free to recommend investments that benefit them, the seller of the product, at the expense of the customer who is saving for their future.

The dangers of bad advice are real, not theoretical. In a summary of dozens of independent academic studies, the White House Council of Economic Advisors has concluded that conflicted advice from brokers costs working families some $17 billion in lost returns on their retirement savings each year, or about 12 percent of their lifetime retirement savings.[2] The non-partisan Government Accountability Office has issued multiple reports warning that there are serious issues of conflicts of interest and deception in 401-Ks, IRAs, and other broker-advised retirement accounts (see e.g. GAO-11-119, January 28, 2011; GAO -13-30, March 7, 2013). Carefully designed academic studies have demonstrated that some brokers systematically steer savers into investments that create losses for the saver, but are more lucrative for the advisor.[3]

Unfortunately, the rules that protect ordinary workers and investors from being steered into sub-standard investment products are weak and have not been updated for decades. The rules for

[1] Americans for Financial Reform is an unprecedented coalition of more than 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.
[2] Council of Economic Advisors, "The Effects of Conflicted Investment Advice on Retirement Savings", February, 2015, Executive Office of the President.
[3] Mullainathan, Sendhil, Noeth, Markus and Schoar, Antoinette, "The Market for Financial Advice: An Audit Study" (March 2012). NBER Working Paper No. 17929.

retirement savings protections established by the Department of Labor (DOL) were written in the 1970s, before the modern era of self-directed retirement investments like 401-Ks and IRAs. These DOL rules are full of loopholes and thus give inadequate protection to most worker retirement savings today. Furthermore, brokers regulated by the Securities and Exchange Commission (SEC) who provide investment advice to retail customers are free to misrepresent themselves as advisers without having to meet the requirement to act in the best interests of their clients that applies to all other investment advisers.

HR 1090 would strike at the heart of regulatory efforts to address these serious problems. First, HR 1090 would prevent DOL from moving forward with its current proposal to improve retirement savings protections until after the SEC has finalized new rules covering the duties of brokers to their customers. This is an unprecedented and unjustified statutory interference with the Department of Labor's ability to oversee protections for retirement savings, which has been within DOL jurisdiction for forty years under the Employee Retirement and Income Security Act (ERISA). It is not justified by anything in the Dodd-Frank Act, as the Dodd-Frank Act in no way affected DOL's jurisdiction over ERISA-covered retirement savings or its responsibility to ensure fiduciary protection for such savings.

The requirement that DOL halt its rulemaking and wait for SEC action is also a transparent effort to delay and hinder needed protections for worker savings. The Department of Labor is far more advanced in the rule writing process than the SEC. The DOL is already moving forward with a proposed rule, while it is unclear when or if the SEC will write new rules for brokers. Requiring DOL to wait for SEC to complete an as yet non-existent rule is a recipe for years of additional delays.

Having first prevented any DOL action prior to an SEC rulemaking, HR 1090 would then add approximately a dozen new analytic and reporting requirements that must be fulfilled before any SEC action to impose fiduciary duty on brokers. These requirements would do nothing to improve the analytical underpinnings of the rule, but would instead encourage additional litigation and delay rulemaking. The SEC has already studied the issue for over a decade. Additional required findings would simply provide the basis for a legal challenge by those industry groups who oppose any efforts to require them to act in their customers' best interests when providing advice. The effect would be to further delay SEC action that is already long overdue.

The combination of delaying the DOL fiduciary rule for retirement savings until the SEC has completed a rule in another area of the financial markets, and then imposing new bureaucratic hurdles on the SEC before a rule can be finalized, is a transparent effort to halt progress in creating crucial protections for retirement savings. We urge you to protect investors and OPPOSE HR 1090.

www.ourfinancialsecurity.org

If you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development

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- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)

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- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

www.ourfinancialsecurity.org

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET

BETTER MARKETS

Chairman Jeb Hensarling
Ranking Member Maxine Waters
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

As the facts show, millions of retirement savers across this country are needlessly losing billions of dollars every year because of conflicts of interest that have been allowed to persist among financial advisers under an outdated, 40 year old rule of the Department of Labor ("DOL"). As a result, indefensibly, those financial advisers are allowed to put their economic interests above the best interests of their clients. [1]

After years of hard work conducting a thorough economic analysis and consulting extensively with the SEC and stakeholders representing all perspectives, the DOL has developed a strong rule proposal to address these conflicts of interest, provide much stronger protections for hardworking Americans struggling to save for a decent retirement, and require that the clients' best interests always be put first. At the same time, the DOL's balanced proposal accommodates the industry's most basic concerns by preserving the ability of advisers to continue charging commission-based compensation. The DOL's thoughtful proposal has resulted from an extraordinarily long deliberative process and comment period, which has included an unprecedented four days of public hearings on its proposed rule. This has put the DOL in a fully informed position to issue a final version soon.

Unfortunately, many members of the financial services industry staunchly oppose the proposed rule regardless of its content and necessity. They are fighting nonstop to preserve the status quo, under which they can recommend investment products to retirement savers that pay lucrative commissions but saddle their clients with high fees and low returns. That is the inevitable result of a 40 year old rule that fails to require that the clients' best interests come first.

A principal argument against the rule is that the DOL should wait for the Securities and Exchange Commission (SEC) to address the conflicts of interest that are exacting such a high toll on millions of American families just trying to save for retirement. Yet as Better Markets and

1 Better Markets, Inc. is a nonprofit organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets.

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others have repeatedly demonstrated, the SEC simply does not have the legal authority to close the loopholes in the DOL's rules under ERISA or to protect retirement savers from conflicted advice about any investment that is not a security. Moreover, after years of considering the issue, the SEC has shown no inclination to raise the standards applicable to broker-dealers who give investment advice about securities. Forcing the DOL to wait for the SEC means indefinite delay in protecting retirement savers, who cannot afford to wait any longer. Notably, the DOL has consulted extensively with the SEC in formulating its rule.

Later today, the Subcommittees on Oversight and Investigations and Capital Markets and Government Sponsored Enterprises will conduct a hearing entitled "Preserving Retirement Security and Investment Choices for All Americans," which we expect will address some of these important issues. I would like to submit two attached items for the hearing record. The first is the comment letter submitted by Better Markets to the DOL on its rule proposal on July 21, 2015, and the second is the testimony that Better Markets delivered at the DOL hearing on the rule proposal on August 11, 2015. In these items, we address the pressing need for better protections against conflicts of interest among advisers, the DOL's proposed solution, and the unfounded attacks against the rule that ardent segments of the financial industry have been launching—including the baseless claim that the solution should be left to the SEC. Following that course would amount to doing nothing and would allow tens of millions of Americans to continue to lose tens of billions of their hard earned dollars every year, money they need to retire with dignity and security.

We appreciate your consideration of our views on this important issue. Please do not hesitate to contact me if you would like to discuss these issues or obtain any additional information that we might be able to provide.

Sincerely,

Dennis M. Kelleher
President & CEO

Attachments:

- Comment Letter of Better Markets submitted to the DOL on its proposed conflicts of interest rule, July 21, 2015
- Testimony of Better Markets at the DOL hearing on its proposed conflict of interest rule, August 11, 2015

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July 21, 2015

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, D.C. 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (DOL RIN 1210—AB32)

Dear Sir or Madam:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposed Rule" or "proposal") published by the Department of Labor ("DOL" or "Department") in the Federal Register on April 20, 2015. The proposal will update the DOL's 40-year rule that defines when a person is providing investment advice and is therefore assuming fiduciary status under the Employee Retirement Income Security Act ("ERISA" or "the Act") and under provisions of the Internal Revenue Code ("Code.")

INTRODUCTION AND SUMMARY

The Proposed Rule has three basic components: (1) an updated rule that closes major loopholes in the existing regulation, to ensure that with few exceptions, anyone who provides investment advice about retirement assets is subject to the fiduciary duty and must put their client's best interest ahead of their own; (2) a collection of new or amended Prohibited Transaction Exemptions ("PTEs") largely designed to permit commission-based compensation for advisers while still protecting investors under the best interest standard; and (3) an exhaustive Regulatory Impact Analysis ("RIA") quantifying the enormous costs to retirement savers of conflicted investment advice, and demonstrating the compelling need for broader application of the fiduciary duty.

The Proposed Rule represents a huge step forward in providing retirement savers with stronger protections against the widespread and damaging conflicts of interest that

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets.

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have been allowed to persist among many financial advisers since the DOL's original rule was adopted in 1975. The Proposed Rule offers a comprehensive, well-supported, and in some respects highly innovative solution to many of the deficiencies in the original rule. We commend the DOL for its proposal, and we strongly support it.

In this comment letter, we (1) review the nature and scope of the problem that the DOL is trying to address in the Proposed Rule; (2) comment on specific aspects of the DOL's proposal; and (3) respond to the principal arguments that opponents of this critical reform have been advancing relentlessly to defeat it.

In summary, we offer the following comments:

- First, the status quo is unacceptable. The DOL's existing rule contains huge loopholes that have no legal or policy justification. Those gaps plainly conflict with the language and intent of ERISA, and they have allowed financial advisers—for decades and with impunity—to siphon off untold *trillions* of dollars in hard-earned savings from workers and retirees struggling to prepare for and maintain a secure and dignified retirement. Specifically—

    - The original DOL rule, now 40 years old, grafted a complex and restrictive multi-part test onto the broad, simple, and clear definition of investment advice that Congress included in ERISA. As a result of this regulatory overlay never intended by Congress, advisers have multiple ways to evade the fiduciary standard of care and loyalty that is so necessary for the protection of retirement savers.

    - The problem is increasingly acute because the retirement landscape has changed profoundly since the rule was first adopted in 1975. Traditional pension plans are becoming a thing of the past, and the vast majority of Americans are now responsible for managing their own retirement assets. And they are confronting a bewildering array of investment options from which they must choose. Moreover, the pool of investors who need advice is expanding rapidly, as 10,000 Baby Boomers reach age 65 every day.

    - By conservative estimates, conflicts of interest among advisers are costing American workers and retirees an average of up to $43 billion per year—or nearly $82,000 per minute. These are lost savings that people need in retirement to meet basic needs and maintain a decent quality of life.

    - America is already facing a retirement crisis, as the majority of Americans have fallen behind in setting aside adequate retirement savings. The gaps in the DOL's old fiduciary duty rule are exacerbating this problem by siphoning away a huge fraction of whatever retirement savings workers have managed to save.

- Second, we applaud the DOL for updating and improving the current rule in critically important respects. For example, the Proposed Rule closes the "regular basis" and "primary basis" loopholes and it applies the protections of the fiduciary standard whenever an adviser urges a retirement saver to roll their savings out of an ERISA plan and into another vehicle such as an IRA. We urge the DOL to adhere to these changes as the proposal is finalized. In addition, we urge the DOL to strengthen the Proposed Rule in certain respects to help ensure that it provides the best possible protections for all workers and retirees, especially those with modest savings who can least afford the bloated commissions and poor returns that result from investment advice corrupted by conflicts of interest. Specifically—

    - The DOL must not yield to those who would exclude advice to IRA owners from the Proposed Rule.

    - The definition of investment advice in the Proposed Rule still includes a "mutual understanding" element that must be removed or modified.

    - The DOL should adhere to its position that educational asset allocation models or interactive materials may not incorporate specific investments available under a plan.

    - The platform provider carve-out should be available only to large plans, as is the seller's exemption.

    - The Best Interest Contract Exemption ("BIC exemption") is a creative mechanism for accommodating industry's desire to preserve their compensation models while protecting investors and providing IRA owners with a remedy where none currently exists. However, it can and should be strengthened in several important respects.

        - The DOL must reject calls to weaken the BIC based on groundless claims about paperwork obligations, the assets classes covered by the exemption, or the disclosure requirements.

        - The DOL should stipulate the minimum required elements of a firm's policies and procedures, and provide a model Best Interest Contract.

        - The DOL should extend the BIC to advisers to all small plan sponsors.

        - The DOL should provide that any violation of the BIC exemption not only gives rise to a cause of action for breach of the contract, but also nullifies the exemption. This applies specifically to any failure to comply with applicable state and federal law and any failure to adopt required policies and procedures.

- The DOL should prohibit the use of mandatory pre-dispute arbitration clauses in the contracts between advisers and investors.

- Finally, we urge the DOL not to be swayed by the onslaught of arguments coming from broker-dealers, insurance companies, and others who seek to kill, weaken, or delay the proposal. In crafting the Proposed Rule, the DOL has already made significant accommodations to industry concerns, as exemplified by the provisions allowing commission-based compensation for advisers. Any further dilution in the Proposed Rule will harm retirement savers and undermine Congress's goal of providing the strongest possible safeguards against conflicts of interest that can severely deplete hard-earned retirement savings. Specifically—

  - The Proposed Rule will help, not hurt, low and middle income investors.

  - The DOL must not be required to wait for the SEC to address flaws in its own standards governing securities advice.

  - The regulatory approach adopted in the United Kingdom and contemplated elsewhere squarely supports the Proposed Rule.

  - The Proposed Rule will not create overwhelming litigation liability.

  - A disclosure regime is no substitute for an affirmative fiduciary duty to put the client's best interest first.

THE PROBLEM

Every day across this country, thousands of workers and retirees sit down with a broker, banker, or insurance agent expecting to receive straightforward, unbiased advice about how to invest the retirement assets they have struggled to set aside in their 401(k) plan or individual retirement account ("IRA"). In the guise of well-informed and objective guidance, the adviser delivers what is in essence a sales pitch and persuades the client to buy a particular annuity, mutual fund, or other product. Yet the client has no idea that the adviser is recommending those investments not because they served the best interest of the client, but because they would pay the adviser a lucrative commission and perhaps enhance his prospects for a bonus.

In fact, the adviser doesn't tell the client what the adviser knows full well: A host of other readily available investments would be much less expensive for the client, and produce much better investment returns in the long run. Over time, the client will lose tens or even hundreds of thousands of dollars as a result of the high-priced and poor-performing investments the adviser has pressed upon him—money that could have helped him meet his basic needs or improve his quality of life in retirement. This deplorable scenario is commonplace, and it is allowed to persist because of loopholes in the DOL's original fiduciary duty rule, adopted in 1975.

The reason for this state of affairs, and the extraordinary toll it is taking on retirement savers, has been the subject of increasingly heated debate since the DOL first attempted to modernize its rule in 2010. At this point, these facts are no longer subject to legitimate dispute: The current rule is deeply flawed, conflicts of interest abound among advisers, and the toll on retirement savers is enormous. Nevertheless, to have a proper context for evaluating the Proposed Rule, it is important to review how far the current rule deviated from Congress's original language and intent; how profoundly the retirement landscape has changed, making those long-standing regulatory gaps so costly in today's world; and how much money retirement savers are actually losing as a direct result of conflicts of interest among advisers.

1. The current rule bears little resemblance to the standard Congress set forth in ERISA, and it is riddled with loopholes that Congress never intended.

Enacted in 1974, ERISA establishes vitally important protections for retirement plans, plan participants, and beneficiaries. It safeguards plan participants by imposing standards of care and undivided loyalty on plan fiduciaries and holds them accountable when they breach those obligations.[2] At the heart of the fiduciary duty is the best interest standard: the obligation to act solely in the interest of plans and plan participants.

The "Congressional Findings and Statement of Policy" in ERISA articulate the profound importance of employee benefit plans, and the need to adopt standards of conduct for plan fiduciaries:

> [T]he continued well-being and security of millions of employees and their dependents are directly affected by these plans .... It is hereby declared to be the policy of this Act to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.[3]

ERISA also set forth a broad, simple, and clear definition specifying when a person becomes a fiduciary by virtue of rendering advice:

> [A] person is a fiduciary with respect to a plan to the extent ... (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to moneys or other property of such plan, or has any authority or responsibility to do so ....[4]

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2 Employee Benefits Security Administration, *Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule*, 80 Fed. Reg. 21928 (Apr. 20, 2015), *henceforth* "Release."

3 Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829, § 2(b), 29 U.S.C. § 1001.

4 29 U.S.C. § 1002(21)(A).

However, in 1975, the DOL promulgated a rule that deviated substantially from this simple definition and inexplicably incorporated a complicated and restrictive five-part test. Pursuant to that test, a person is deemed to be rendering investment advice only if they:

(1) make recommendations as to the advisability of investing in, purchasing, or selling securities or other property;
(2) on a regular basis;
(3) pursuant to a mutual agreement, arrangement, or understanding that the advice;
(4) will serve as a primary basis for investment decisions; and
(5) will be individualized to the particular needs of the plan.[5]

None of these additional elements have any basis in ERISA itself,[6] and the rule thus "significantly narrowed the breadth of the statutory definition of fiduciary investment advice."[7] As the DOL aptly describes, the current rule has had the perverse effect of undermining rather than promoting Congress's goal of protecting retirement assets:

> Instead of ensuring that trusted advisers give prudent and unbiased advice in accordance with fiduciary norms, the current regulation erects a multi-part series of technical impediments to fiduciary responsibility. The Department is concerned that the specific elements of the five-part test—not found in the text of the Act or Code—now work to frustrate statutory goals and defeat advice recipients' legitimate expectations.[8]

The opportunities for abuse under this rule are obvious and many in the financial industry have taken full advantage of them. Too often, advisers exploit this test in various ways, often by simply claiming that their advice is not "regular," is not "individualized," or is not the "primary basis" for an investment decision. Or, they claim that the advice is really education and not advice at all. Accordingly, advisers can and do provide investment advice to retirement savers that is not in the client's best interests.

For example, if a retirement plan participant seeks one-time, individualized advice on a complex investment, the adviser has no fiduciary duty because that advice is not provided on a "regular basis" even though the investment may involve the commitment of a substantial amount of money.[9] Similarly, a plan participant may regularly consult with an adviser and even rely on the adviser's advice as the primary basis for investment decisions, but unless the adviser agreed and the participant understood that the advice would serve as

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5 29 C.F.R. § 2510.3-21(c).
6 Release at 21933.
7 Release at 21928.
8 Release at 21933.
9 Testimony of Phyllis C. Borzi, Assistant Secretary of Labor, Employee Benefits Security Administration Before the House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions (July 26, 2011), *available at* http://www.dol.gov/ebsa/newsroom/ty072611.html.

the "primary basis" for investment decisions, the adviser would not be considered a fiduciary.[10]

Further evidence suggests that advisers purposely exploit these and other loopholes in the five-part test. A DOL inspector general report identified an egregious example where advisers with "significant undisclosed conflicts of interest attempted to avoid meeting the criteria for ERISA fiduciary status under the current five-part test by simply stating in their adviser contract that they were not fiduciaries."[11] In addition, one ERISA attorney informed the Government Accountability Office ("GAO") "that although service providers give investment recommendations, they will include a provision in their contract that states that the investment recommendations provided are not intended to be the primary basis for decision making," as a means of avoiding the duty.[12]

The RIA explains that the five-part test in the current rule has also proven to be a major obstacle in the DOL's effort to bring enforcement actions against advisers who breach the fiduciary duty. Both the regular basis element and the mutual understanding element have repeatedly thwarted the DOL's ability to hold advisers accountable.[13]

Compounding these problems is a 2005 interpretive guidance stipulating that advice about a distribution is not "investment advice" and therefore not subject to the fiduciary duty. As a result, when advisers urge investors to roll their retirement plan savings into an IRA, and advise them to populate that IRA with all sorts of subpar investment products that pay handsome commissions for the adviser, the rule offers no protections.

Rolling funds out of a defined benefit ("DB") plan or defined contribution ("DC") plan and into an IRA is one of the most important financial decisions people will make. Many savers take that step when they are nearing retirement and must decide how best to consolidate and manage assets that have built up in a number of 401(k) accounts. This is a critical juncture, involving key decisions about how to invest all or a substantial part of a worker's retirement savings. Under the current rule and the related guidance, the law cannot ensure that those savers receive advice that will serve their best interest. As a result, their rolled-over assets may be placed in high-cost, low-quality investments for the duration of their retirement, eating up a huge portion of their savings while unjustly benefitting the advisers and firms who steered them into such mediocre investments for their own gain.

Including IRAs and rollovers within the scope of fiduciary investment advice is especially important critical in light of recent trends. Although these retirement savings vehicles had just been created when the initial rule was promulgated, they have experienced

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10 *Id.*

11 U.S. Department of Labor, Office of Inspector General, Report No. 09-10-001-12-121, *EBSA Needs to Do More to Protect Retirement Plan Assets from Conflicts of Interest* (2010).

12 U.S. Government Accountability Office, *GAO-11-119, 401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest* (2011), at 24.

13 U.S. Department of Labor, *Regulatory Impact Analysis* 149-50 (April 14, 2015), *henceforth* "RIA."

massive growth. They now hold $7.6 trillion in retirement assets.[14] Further, the GAO reported that "from 1996 to 2008, over 90 percent of funds flowing into traditional IRAs came from rollovers primarily from employer-sponsored retirement plans,"[15] with nearly $273 billion in assets rolled over in 2008 alone.[16] In 2013, it is estimated that $358 billion was rolled over,[17] and rollovers "are expected to approach $2.5 trillion during the next 5 years."[18] The frightening reality is that "an ERISA plan investor who rolls her retirement savings into an IRA could lose 12 to 24 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser."[19]

2. The retirement landscape has changed dramatically during the past 40 years, forcing investors to manage their own retirement assets while also presenting them with increasingly complex choices.

The 1975 fiduciary duty rule was designed at a time when DB retirement plans dominated the retirement landscape. They pay out a guaranteed amount upon retirement and are managed by a professional without employee input. At that time, the vast majority of all workers—33 million or 74 percent—were in large DB plans.[20] Companies like General Motors, with sophisticated investment management staff, invested on behalf of all their workers, spreading risk and reward from the market so that all employees would be assured of a comfortable retirement. In 1975, 33 million individuals participated in these DB plans, while only 11 million workers took part in DC plans.[21] Furthermore, IRAs had only just been created in 1974, and 401(k) plans were not yet in existence.

In recent years there has been a significant shift from traditional pensions to DC plans such as 401(k)s and IRAs. While DB plans are funded by employers, DC plans are funded primarily with employee contributions. DC plans are therefore a less costly retirement plan for employers to offer, making them a more attractive option in recent decades. DB plans held 72 percent of retirement plan assets in 1975, whereas they held only 34 percent in 2011. Including IRA assets, DB plans held only 20 percent of private retirement assets in 2011. As of 2012, 90 million people, or more than two-thirds of workers with retirement plans, had DC plans.[22]

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14 Investment Company Institute, *the U.S. Retirement Market: First Quarter 2015*, Table 1, *available at* https://www.ici.org/info/ret_15_q2_data.xls.

15 U.S. Government Accountability Office, *GAO-11-119, 401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest* 10 (2011), *citing* Investment Company Institute, *The U.S. Retirement Market, Second Quarter 2012, available at* http://www.ici.org/info/ret_12_q2_data.xls.

16 Government Accountability Office, *GAO-13-30, 401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants* 10 (2013).

17 Jason Zweig, *Who's Training Your Retirement Navigator?*, THE WALL STREET JOURNAL (Feb. 14, 2014).

18 RIA at 3, *noting* Cerulli Associates, *Retirement Markets 2014: Sizing Opportunities in Private and Public Retirement Plans* (2014).

19 RIA at 3.

20 *Id.* at 5.

21 *Id.*

22 *Id.*

This shift away from DB plans and towards DC plans means Americans are forced to invest their retirement assets on their own and bear the consequences of those investment decisions. However, they often lack the expertise, education, and training to make those judgments, and they face "a much greater variety of investments to choose from, creating a greater need for expert advice."[23] At the same time, "innovations in compensation arrangements have multiplied the opportunities for self-dealing and reduced the transparency of fees."[24] Despite the magnitude of these changes, the rule remains as it was in 1975, with its vast loopholes.

Taken together, these trends have created alarming vulnerabilities among retirement savers: a high degree of investor dependence on expert advice, a huge incentive among advisers to pursue fees and commissions from the trillions of dollars held in 401(k)s and IRAs, and a 40-year rule offering scant protection. The Proposed Rule is long overdue and must be finalized as soon as possible.

3. By conservative estimates, the conflicts of interest permitted under the current rule are costing retirement savers up to $43 billion a year.

Conflicts of interest among financial advisers are causing massive harm to American workers and retirees. Just focusing on one segment of the IRA market, the Council of Economic Advisers estimates that between $1.05 and $3.26 trillion in IRA assets are affected by such conflicted advice,[25] and as much as $33 billion is lost to IRA investors each year.[26] The DOL, in its RIA, estimates that conflicts of interest that result in poor investment returns will cost IRA investors as much as $430 billion over 10 years if the loopholes are not closed.[27] That's an average of $43 billion a year—or nearly $82,000 a minute—that retirement savers are losing due to conflicts of interest.

These estimates are extremely conservative, as they assess the harm arising from just one type of investment (mutual funds), in just one type of retirement account (IRAs). As observed in the Release, "the total impact could be much larger," as "insurance products, Exchange Traded Funds, individual stocks and bonds, and other products are all sold by brokers with conflicts of interest."[28]

Insurance products create particularly dangerous opportunities for abuse of retirement savers. Insurance "products are notoriously complex"[29] and "most IRA investors therefore have the ability to judge neither the suitability nor the price of any recommended product." Absent a fiduciary standard, it is possible for insurance brokers to "inefficiently

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23 Release at 21935.
24 Release at 21935.
25 The White House Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (Feb. 2015), at 19, *available at* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.
26 *Id.* at 20.
27 RIA at 8.
28 Release at 21952.
29 RIA at 79-80.

withhold information and distort consumer choices by providing misleading information or operating in their own self-interests."[30] Moreover, "insurance product commissions are often substantially higher than [broker-dealer] mutual fund load shares or securities commissions," encouraging brokers to sell them over alternate products.[31]

Without a strong DOL rule in place, investors are left exposed. Insurance products that are regulated as securities fall under the weak suitability standards administered by FINRA, an industry self-regulatory organization. And other insurance products such as fixed and equity-indexed annuities are subject to the patchwork of standards under state law, where even a bare suitability standard may not apply. Delaware, for example, applies the suitability standard only to insurance brokers when dealing with seniors,[32] and New Mexico and the U.S. territories have no minimum standard of care at all.[33] Anything short of the fiduciary duty leaves ample room for abuse.

The situation is made worse because investors generally do not know these conflicts of interest are allowed to exist and that advisers may make recommendations that don't serve their clients' best interests. One study found that 59 percent of investors believed "financial advisors or financial consultants" were subject to the same legal requirements as "registered investment advisers."[34] In fact, only registered investment advisers have a fiduciary duty under the securities laws while financial advisers or consultants—titles often used by broker-dealer representatives—do not.

4. The flaws in the current rule have contributed to the larger retirement crisis that America is facing.

This situation is contributing to a retirement crisis that already threatens devastating consequences. The retirement outlook for many Americans is bleak.[35] Every day, 10,000 Baby Boomers turn 65, but many lack sufficient savings for retirement. The GAO recently issued a report showing that, of households nearing retirement (age 55 to 64), only 59 percent have **any** retirement savings.[36] Fourteen percent have other resources or a defined benefit plan, but a full 27 percent of near retirement households have neither retirement savings nor a pension.

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30 RIA at 92.
31 RIA at 73.
32 18 Del. Code. Regs. § 1214.
33 National Association of Insurance Commissioners, *Suitability In Annuity Transactions Model Regulation*, at ST-275-3 - ST-275-9, *available at* http://www.naic.org/store/free/MDL-275.pdf.
34 Angela Hung et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* 89 (2008).
35 House Committee on the Education and the Workforce, *Time to Modernize Multiemployer Pension System* (Apr. 29, 2015), *available at* http://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=398799
36 U.S. Government Accountability Office, *GAO-15-419, Retirement Security: Most Households Approaching Retirement Have Low Retirement Savings* 9 (2015).

Among those households with savings, GAO reports 20 percent have saved less than $50,000, and another 19 percent have saved less than $200,000. Another study found 44 percent of Late Baby Boomers and Gen-Xers lack adequate retirement income.[37]

It is not only those in or nearing retirement who are facing a crisis; 36 percent of all Americans report they have nothing saved for retirement.[38] 23 percent of traditional IRAs and 28.6 percent of Roth IRAs have less than $5,000.[39] In 2012, only 39.4 percent of workers participated in a workplace retirement plan.[40] It is these workers who are most at risk of relying on Social Security for a significant portion of their retirement income.

The retirement savings crisis affects the poorest most deeply: Between 77 and 87 percent of lowest-income households are at risk for having insufficient retirement savings,[41] only 15.4 percent of Americans in the lowest two income-quintiles have a 401(k) plan, and only 14.75 percent have an IRA.[42] However, between 13 and 17 percent of the highest-income households are at risk of having insufficient savings during retirement as well.[43] The crisis especially impacts minorities.[44]

The solution to this problem has several different components. First, it is critical to encourage and enable American workers to set aside as much as they can for retirement. In addition to the long-standing preferential tax treatment afforded retirements savings, the Administration has explored new ways to promote saving through initiatives such as the myRA program administered by the Department of the Treasury.

But equally important is making sure that people get the most out of what they have managed to set aside on a tax advantaged basis, which is why the DOL's Proposed Rule is so important. If financial advisers are allowed to siphon off a large portion of their clients'

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37 Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

38 Nanci Hellmich, *A third of people have nothing saved for retirement*, USA TODAY (Aug. 18, 2014), *available at* http://www.cnbc.com/id/101926802#_gus

39 Investment Company Institute, *The IRA Investor Profile: Traditional IRA Investors' Activity, 2007–2012*, at 47 (March 2014), available at http://www.ici.org/pdf/rpt_14_ira_traditional.pdf.

40 Miller, M. Reuters, *Column: Why minorities are losing the retirement race*, REUTERS (Dec. 12, 2013), *available at* http://www.reuters.com/article/2013/12/12/us-column-miller-minority-idUSBRE9BB0KJ20131212.

41 Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), at 4, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

42 United States Census Bureau, *Table 2. Percent Holding Assets for Households, by Type of Asset Owned and Selected Characteristics: 2011, available at* http://www.census.gov/people/wealth/files/Wealth_Tables_2011.xlsx

43 Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), at 4, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

44 National Institute on Retirement Security, *Race and Retirement Insecurity in the United States* (Dec. 2013), at 7, *available at* http://www.nirsonline.org/storage/nirs/documents/Race%20and%20Retirement%20Insecurity/race_and_retirement_insecurity_final.pdf.

retirement savings, then the prospects for a secure, dignified, and independent retirement will continue to fade.

COMMENTS ON THE PROPOSED RULE

We commend the DOL for recognizing and acting upon the critical need to update its fiduciary duty rule, to expand its scope, and to more fully protect our current and future retirees from conflicts of interests that drain billions from their savings annually and threaten their retirement security. The strong proposal will more effectively limit harmful conflicts of interest among advisers and help Americans better prepare for the financial challenges of retirement.

1. The Proposed Rule closes key loopholes and expressly covers rollovers and advice to IRA owners.

The Proposed Rule incorporates a revised and vastly improved definition of "investment advice" that triggers the fiduciary duty. The definition is an appropriately functional one, keyed to the activities of the adviser without regard to titles or regulatory registration status. It simplifies and reformulates the relevant portion of the definition as follows:

> A person renders investment advice with respect to moneys or other property of a plan or IRA [if] such person—
>
> Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.[45]

Stricken from the definition is the "regular basis requirement" and the "primary basis requirement." In addition, as the language above makes clear, the proposal expressly extends the new definition of investment advice to recommendations regarding IRA assets. And elsewhere, the proposal expressly covers recommendations "to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA."[46]

With these simple modifications, the DOL has dramatically improved upon its current rule and brought its provisions into much closer alignment with the broad language and protective purposes of ERISA.

2. The DOL must not yield to those who would exclude IRAs from the Proposed Rule.

[45] Release at 21957; Proposed Rule § 2510.3-21(a)(2)(ii).
[46] Release at 21957.

The Release makes clear that the changes in the investment advice definition in the Proposed Rule will apply both under ERISA and under the counterpart provisions in the Code.[47] "As a result, it applies to persons who give investment advice to IRAs," as well as those who give investment advice to plans and plan participants.[48]

This is an essential feature of the proposal, and it is critical that the DOL adhere to it in the final rule. Since the 2010 rule proposal was issued, members of the industry—notably brokers—have been particularly vociferous in resisting application of the new rule to protect IRA owners. But, their arguments are baseless in light of the important role that IRAs play in retirement planning, the policy goals underlying ERISA, the nature of IRA accounts, and the BIC exemption that addresses industry's primary goal of maintaining the commission compensation model.

First, the stakes are huge, as IRAs today account for a huge portion of Americans' retirement savings: $7.6 trillion.[49] Second, there is no legal or policy rationale for differentiating IRAs from plans in this context, since they both hold retirement assets and they both receive preferential tax treatment. Indeed, as the Release notes, "the vast majority of IRA assets today are attributable to rollovers from plans."[50]

In addition, IRA owners are even more in need of the fiduciary protections against conflicts of interest than plan participants. For example, IRA owners "do not have the benefit of an independent plan fiduciary to represent their interests in selecting a menu of investment options."[51] Moreover, IRA owners tend to have large account balances, and they are more likely to be elderly—and therefore especially susceptible to abuse and unable to recover any losses that they suffer from bad investment advice. And currently, IRA owners have no recourse if they are suffer damages from conflicted advice: They cannot sue under ERISA, and the DOL cannot sue on their behalf.

Finally, the DOL has addressed the brokers' primary concern in the BIC exemption, which will allow them to continue receiving commission compensation for rendering advice to IRA owners, subject to important limitations and safeguards.

For all of the foregoing reasons, the DOL must adhere to its position that the new protections under the Proposed Rule should be extended to IRAs.

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47 Release at 21946.
48 *Id.*
49 Investment Company Institute, *the U.S. Retirement Market: First Quarter 2015*, Table 1, *available at* https://www.ici.org/info/ret_15_q2_data.xls.
50 Release at 21947.
51 *Id.*

3. The core definition of investment advice still includes a mutual understanding prong that must be removed or modified.

The Proposed Rule still includes language indicating that, before the fiduciary duty applies, the adviser and client must arrive at an agreement or understanding about the individualized nature of the advice and its role in investment decision-making.

Specifically, the Proposed Rule provides that advice is not "investment advice" subject to the fiduciary standard unless the adviser "render[s] the advice pursuant to a written or verbal **agreement, arrangement, or understanding** that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions."[52]

The DOL must remove or revise this "understanding" element. It is a vestige of the current rule that restricted "investment advice" to the unrealistic scenario in which there was "a mutual understanding" that the advice would serve as a primary basis for investment decisions and would be "individualized to the particular needs of the plan." It will inevitably inspire attempts to evade the fiduciary duty. As documented in the Release, the old correlate of this language has been invoked repeatedly as a defense against the application of the fiduciary duty.[53]

The Proposed Rule creates a similar threat of evasion. Some advisers will claim that they had no actual agreement or understanding with the client that the advice provided was "individualized to, or specifically directed to, the client for consideration in making investment decisions." While the Release explains that "[t]he parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice," it goes on to confirm that they nevertheless "must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions."[54]

The Proposed Rule creates this risk of evasion unnecessarily, since the DOL does not need this language to achieve its regulatory objective of distinguishing advice "to the general public or to no one in particular."[55]

The simplest and most effective remedy for this problem would be for the DOL to delete the reference to agreements or understandings, thus only requiring that the advice simply be "individualized or directed" to the client. Absent this revision, the DOL should at least modify the provision to expressly incorporate a reasonable person standard. This would limit the potential for abuse and evasion by making clear that regardless of whether the investor actually had arrived at the particular understanding specified in the rule, the

52 Release at 21963.
53 Release at 21934; RIA at 150.
54 Release at 21940.
55 Release at 21940.

fiduciary duty would nevertheless apply, if under all the circumstances, a reasonable person would conclude that was the parties' intent.

4. The DOL should adhere to its position that educational asset allocation models or interactive materials may not incorporate specific investments available under a plan.

In 1996, the DOL issued an interpretive bulletin (IB 96-1) to make clear that furnishing specified categories of financial information to investors would not constitute the rendering of investment advice.[56] With an important modification, the Propose Rule largely preserves the basic provisions of the interpretive bulletin. It identifies the following categories of information as education that will not trigger fiduciary status:

(1) Information about a retirement plan or IRA, such as costs and benefits of participation, contributions and distributions, and other characteristics of such plans;
(2) General financial, investment, and retirement information, such as information about concepts like risk and return, historic differences of rates of return for varying asset classes, and effects of inflation;
(3) Asset allocation models that provide models of asset allocation portfolios that of hypothetical individuals with different time horizons and risk profiles; and
(4) Interactive investment materials such as questionnaires, worksheets, software, and other materials which help estimate future retirement income needs, as well as assess the impact of different asset allocations on retirement income.[57]

This provision reflects a widely held view that investors are actually better served if they have access to bona fide educational materials provided to them outside the scope of the fiduciary duty. Such materials can assist investors in making important "investment and retirement-related decisions appropriate to their particular situations."[58]

There is nevertheless the danger that unscrupulous advisers will attempt to make investment recommendations in the guise of education, thus evading the fiduciary duty that should apply. To address this threat, the Proposed Rule correctly modifies the 1996 interpretive bulletin in an important respect: It flatly prohibits the use of specific investment products available under the plan or IRA in asset allocation models and interactive investment materials.[59] Under the 1996 bulletin, the DOL permitted such references to specific investments, as long as they were accompanied by a statement noting that other similar investments may be available under the plan and identifying where information on those investments could be obtained.[60]

The Release explains the compelling reasons for this change, and the DOL should adhere to it. The identification of specific investment alternatives that are available under a

56 29 C.F.R. 2509.96-1(d).
57 Release at 21944, Proposed Rule § 2510.3-21(b)(6).
58 RIA at 22.
59 Release at 21945.
60 Release at 21945, n. 23.

plan in such models and materials "function as tailored investment recommendations, and can effectively steer recipients to particular investments, but without adequate protection against potential abuse."[61] Moreover, as the DOL observes, cautionary disclosures and caveats appear to have limited effectiveness in countering the powerfully suggestive effects of incorporating specific investments in models or hypotheticals.

This modification deserves special emphasis because it highlights a recurrent and profoundly important principle that must guide the DOL as it defends and finalizes its Proposed Rule. Investors are extremely vulnerable to subtle but powerful influences exerted by financial advisers who are bent on taking advantage of them. All of the safeguards in the Proposed Rule must be evaluated with this in mind.

5. The platform provider carve-out should be available only to large plans, as is the seller's exemption.

The Proposed Rule includes a carve-out for service providers, such as record keepers and third party administrators, who market or make available a platform or menu of investment options to participant-directed retirement plans under ERISA. An important condition of the carve-out is that the platform provider disclose in writing that they are not undertaking to provide impartial investment advice or give advice in a fiduciary capacity.[62] The Proposed Rule should go further and limit the application of this carve-out to large plans. The Proposed Rule appropriately adopts this limitation to ensure that small plans are not vulnerable under the "seller's exemption," and the DOL must similarly protect small plans under the platform provider carve-out as well.

Conflicts of interest among platform providers pose a genuine threat to plan sponsors and ultimately plan participants. Platform providers are in a position to take advantage of the plans to whom they market their services. As with advisers, platform providers have differing compensation models, including revenue-sharing payments from other service providers. Furthermore, the platform provider may include proprietary or affiliated products on its menu. Such revenue-sharing payments and the offering of proprietary or affiliated products can enable conflicts of interest to permeate the platform offered to plan sponsors.

Research has shown these conflicts exist. One study found that platform providers are more likely to include proprietary products on their menus, and that poorly performing proprietary products are not appropriately removed from platforms.[63] For example, the study found that the lowest-performing unaffiliated funds had a 25.5 percent probability of being removed from the platform, whereas the lowest-performing proprietary funds had only a 13.7 percent probability of being removed.[64] In another report, the GAO also found

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61 Release at 21945.

62 Release at 21943.

63 Veronika K. Pool, Clemens Sialm, and Irina Stefanescu, *It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) plans*, Federal Reserve Board (2014), *available at* http://www.federalreserve.gov/econresdata/feds/2014/files/201496pap.pdf.

64 *Id.*, at 13.

that service providers "may suggest funds that have poorer performance or higher costs for participants compared with other available funds" when they receive revenue sharing payments from those funds.[65] Such low performance and high costs harm plan sponsors and their participants.

An important premise of this carve-out is that platform providers interact with plan fiduciaries who serve as a layer of protection for the benefit of plan participants. This may be a legitimate assumption in general, but it is not always true. In particular, plan fiduciaries for small plans may lack knowledge, experience, or sophistication in the area of retirement investing or retirement plan design. As a result, they may not fully appreciate the role of the platform provider or understand the disclosures required of the provider. And they may be susceptible to advice and recommendations that are camouflaged merely as the presentation of alternatives or marketing statements. In short, the conflicts of interest that influence platform providers may harm plans and their participants under the carve-out.

For this reason, we urge the DOL to limit the scope of this carve-out to large plans that have a presumptively greater degree of sophistication and are better equipped to protect the interests of plan participant as they negotiate with platform providers. As suggested by the DOL in connection with the seller's exemption, small businesses are similar to retail investors in terms of their need for protection under the fiduciary standard. Limiting the platform provider carve-out to small plans is therefore appropriate.

6. The Best Interest Contract Exemption is creative mechanism for accommodating industry's desire to preserve their compensation models while protecting investors and providing IRA owners with a remedy where none currently exists. However, it can and should be strengthened in several important respects.

One of the most important and novel aspects of the Proposed Rule is the Best Interest Contract Exemption ("BIC" exemption). As explained in the Release, it is intended to "flexibly accommodate a wide range of current business practices" and to "permit fiduciaries to continue to receive a wide variety of types of compensation that would otherwise be prohibited," while "minimizing the harmful impact of conflicts of interest on the quality of advice."[66]

Under ERISA, exemptions must meet a three-part statutory test. As a condition of granting an individual or class exemption, the Secretary must find that 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 the plan.[67]

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65 U.S. Government Accountability Office, *GAO-11-119, 401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest* (2011), at 16.

66 Release at 21966.

67 Release at 21964; 29 U.S.C. § 1108.

This is a high standard that focuses on the protection of plans, participants, and beneficiaries, without regard to the costs, disruptions, or other burdens that the members of the regulated industry might face. In determining whether to grant an exemption, the DOL has the authority to condition that grant on compliance with stipulated requirements.

Whether or not the BIC exemption actually satisfies this standard is open to debate. On the one hand, forms of adviser compensation that vary with the advice given, such as commissions, clearly give rise to the very type of conflict of interest that ERISA was designed to prohibit.[68] The case law reflects Congress's intent that ERISA's prohibited transactions be applied with the utmost rigor:[69]

> With the exception of the provision in § 1108 for the granting of exemptions by the Secretary on a case-by-case basis, it is apparent that Congress intended § 1106 to be virtually a per se prohibition against the enumerated transactions. In interpreting the prohibitions of § 1106(b), the Third Circuit discussed the provision in light of the underlying policy goals of ERISA.
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> > We note the national public interest in safeguarding anticipated employee benefits by establishing minimum standards to protect employee benefit plans. The substantial growth of plans affecting the security of millions of employees and their dependents, as well as the limited resources of the Department of Labor in the enforcement of ERISA, leads us to believe that Congress intended to create an easily applied per se prohibition of the type of transaction in question.

Moreover, financial regulators in other countries regard commissions as such a serious threat to sound investment advice that they have already imposed, or are considering imposing, an outright ban on adviser commission compensation.[70]

On the other hand, the BIC imposes an impressive array of affirmative obligations and strict prohibitions on any adviser who seeks to benefit from the compensation models it would permit. First, the BIC would have to be entered not just by the individual adviser, but also by the adviser's financial institution and its affiliates and related entities. Once subject to the BIC, advisers would have to:

1. Acknowledge fiduciary status;

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[68] *See* Release at 21967, citing ERISA § 406(b) and Internal Revenue Code § 4975(a), (b), and (c), which prohibit conflict of interest transactions and third-party payments by investment advice fiduciaries.

[69] *McDougall v. Donovan*, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982), citing *Cutaiar v. Marshall*, 590 F.2d 523, 529 (3d Cir. 1979).

[70] *See supra* at 31 (rebuttal of industry arguments); RIA at 42-50.

2. Abide by "Impartial conduct standards," including the duty to provide best interest advice, as interpreted under ERISA and the law of trusts;

3. Refrain from making recommendations if the compensation received exceeds what is reasonable;

4. Warrant the adoption of policies and procedures designed to mitigate conflicts of interest and ensure compliance with the impartial conduct standards;

5. Make extensive disclosures regarding material conflicts of interest, costs, and direct and indirect compensation, over various time periods;

6. Maintain data for regulatory oversight for at least six years;

7. Limit compensation to that which is generated by a list of permissible assets, commonly purchased by plans; and

8. Submit to private actions for breach of contract for violations of the BIC, albeit subject to possible mandatory arbitration.

In addition, the BIC creates a remedy for IRA owners where none currently exists, by providing them with a breach of contract claim if an adviser fails to comply with the terms and conditions of the exemption. And it prohibits the use of exculpatory or liability limiting clauses in the contract itself, which have been used so often under the current rule to evade the fiduciary duty.

On balance, and in light of all these provisions, we view the BIC as a positive regulatory measure. It should lay to rest once and for all industry's dire and disingenuous prediction that the Proposed Rule would ban commissions, destroy their business models, and force them to withdraw their advisory services (often riddled with conflicts) from investors who supposedly cannot afford fee-based advice.

However, to help ensure that the BIC exemption adequately protects investors while affording advisers the compensation flexibility they seek, Better Markets urges the DOL to revise the BIC in several respects. First and foremost, and as discussed below, it is critical that the DOL stand firm against industry claims that the BIC is unworkable in its current form and should be relaxed.

A. The DOL must reject calls to weaken the BIC.

The "paperwork" objection.

One argument increasingly voiced by industry opponents of the Propose Rule is that the BIC exemption is unworkable essentially because of the simple paperwork requirement

that the adviser and client sign a contract before the adviser can provide investment advice.[71] Variants of this claim include the notion that advisers won't be able to promote themselves and their services to a client before a contract is signed, or that the mere act of signing the BIC would be confusing or off-putting to clients.

These claims border on the absurd. First, the language of the BIC exemption is crystal clear. It only requires the adviser to enter the contract "**prior to recommending**" that the investor purchase, sell, or hold any of the permitted assets.[72] Thus, nothing in the BIC exemption prevents an adviser from discussing his qualifications, services, and compensation, or the investor's goals and expectations, before entering the contract. Of course, if the adviser seeks to influence the investor by making explicit or implicit investment recommendations, then the exemption appropriately requires that a contract first be signed.

With respect to the claim that paperwork will put clients ill at ease, suffice it to say that the financial services industry has never been shy about asking clients to sign reams of account documents as a condition of providing their services when it serves the adviser's interest in binding the client to a host of waivers and stipulations (including mandatory arbitration clauses.) In reality, if the provisions of the contract are properly explained to the investor, the impact on the client is likely to be very positive. Investors will be gratified to know that the adviser is duty bound to put their interests first and to comply with all of the protective measures required under the BIC exemption.[73]

The "limited assets" objection.

Opponents of the Proposed Rule have also objected to the list of permissible assets that can be the subject of advice under the BIC and the source of commission compensation or third-party payments. The BIC appropriately limits the types of assets that an adviser can recommend as a condition of receiving otherwise prohibited compensation. The list of investments is actually very broad, and it includes all classes of mainstream, transparent, and liquid financial products, including bank CDs, mutual funds, exchange-traded REITS, exchange-traded funds, corporate bonds, and equity securities.[74]

DOL should reject calls to expand this list in the Proposed Rule. The proposed categories of investments will enable an adviser to meet the needs of retail investors, while limiting risks. As noted in the Release, investors who seek exposure to more exotic investments may be able to access those products through pooled investments funds that are permitted, such as mutual funds.[75] And investors will always have unfettered access to all types of investment products, whether or not on the list, pursuant to the

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71 *FINRA's Ketchum Blasts DOL Fiduciary Plan; White House Says 'Work With Us'*, THINKADVISOR (May 27, 2015), *available at* http://www.thinkadvisor.com/2015/05/27/finras-ketchum-blasts-dol-fiduciary-plan-white-hou.

72 Proposed Best Interest Contract Exemption, Section II(a) (emphasis added).

73 The BIC exemption applies only to retirement accounts and plans. It does not apply to any other investments.

74 Release at 21967.

75 Release at 21967.

recommendations of an adviser who does not rely on the BIC exemption, pursuant to their own personal determination about how best to invest their retirement savings, or through a non-retirement investment account.

To the extent other types of investments not on the list can provide "beneficial investment strategies" for investors with accompanying safeguards or risk limiting factors, the DOL encourages parties to apply for individual or class exemptions so those can be considered. Finally, advisers who feel compelled to recommend investments not on the list always have the option to forego commissions or related forms of compensation, switch to a fee-based model, and draw from a wider array of products—subject to the best interest standard.

The "disclosure" objection.

The BIC exemption requires advisers to make a variety of disclosures to clients in the contract itself, at the point of sale, and annually. Those disclosures must provide information about conflicts of interest, total and projected costs of investments, compensation, and other aspects of the advisory transaction. Some have argued that these disclosure requirements are too burdensome and must be scaled back.

This call for less robust disclosure also should be rejected. The required disclosures are all material, appropriate, and necessary to ensure that clients fully understand the conflicts of interest that are influencing any adviser relying on the BIC exemption. Moreover, this argument rests on exaggerated claims about the costs and burdens of complying with the disclosure requirements. In this information age, massive amounts of data can be assembled, disseminated, revised, and updated with relative ease.

We submit that the disclosure requirements should actually be enhanced in terms of form and timing. It is widely acknowledged that disclosures do little to protect investors if they are not clear and intelligible; prominently displayed; delivered in a timely fashion; and unaccompanied by disclaimers or qualifiers that negate their impact.[76]

To ensure that these criteria are met, and that all of the disclosure obligations in the BIC and elsewhere in the Proposed Rule fulfill their intended purpose, the DOL should establish more prescriptions about the form and timing of all required disclosures. They all must be written in plain English; conspicuously placed in an appropriately large font; and, especially with respect to transaction disclosures, delivered sufficiently in advance of the transaction to give investors a meaningful opportunity to review, understand, discuss, and assimilate the content of the disclosure. And any written or verbal communications from an adviser aimed at contradicting, distorting, or minimizing the importance of any required disclosures should be strictly prohibited.

Finally, the DOL must not adopt a "cigarette warning" style of disclosure in place of the point of sale disclosures required under the Proposed Rule.[77] Such warnings are no

[76] *See* RIA at 193-97.
[77] Release at 21974.

substitute for substantive disclosures regarding fees and costs. In fact, the DOL should require advisers invoking the BIC exemption to provide **both** the detailed point of sale disclosures as proposed, as well as a general warning or notice to the effect that: (1) the adviser is required to make specified disclosures at the point of sale, and the investors should read and understand them; and (2) those disclosures are important, as the fees charged in connection with an investment can significantly reduce the amount that the client can invest over time.

B. DOL should stipulate the minimum required elements of the policies and procedures, and provide a model Best Interest Contract.

Under the BIC exemption, each financial institution must warrant that is has adopted written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest and ensure that advisers adhere to the Impartial Conduct Standards.[78] This is an extremely important component of the BIC exemption, as it will promote compliance by advisers and enable the DOL to more effectively oversee and enforce the BIC exemption requirements.

In the Release, the DOL explains that it has chosen not to mandate the specific content of the policies and procedures.[79] The premise is that financial institutions should have flexibility to develop policies and procedures that are tailored to their specific business models. Although giving firms some flexibility serves a legitimate purpose, the DOL should nevertheless set forth the specific core provisions that every set of policies and procedures must include at a minimum. This approach will achieve both objectives: giving firms the leeway they need while ensuring that the policies and procedures are sufficiently robust.

In addition, the DOL should consider providing other guidance in the form of a model contract under the BIC exemption. The DOL has provided useful guidance in connection with some of the disclosure requirements. For example, Appendices I and II set forth exemplars of required web-based disclosures and charts relating to compensation and costs. Along these lines, the DOL should consider providing a model contract that sets a minimum standard by which all contracts can be measured. This approach promotes compliance with the rule and consistency among advisers, and it will also facilitate examinations by DOL.

C. DOL should extend the BIC exemption to advisers to all small plan sponsors.

Under the Proposed Rule, the BIC would be available not only to advisers who serve individual investors, but also advisers to small, **non-participant directed** plans, defined as plans with fewer than 100 participants.[80] The Release explains that such small plans are appropriately categorized, along with individual plan participants and IRA owners, as retail investors.[81] The rationale is that, unlike larger plans that presumably have a high degree of financial sophistication, smaller plans are also vulnerable to abuse at the hands of advisers

[78] Release at 21970.
[79] Release at 21971.
[80] Release at 21968.
[81] *Id.*

with conflicts of interest. By extending the BIC exemption to those advisers, the Proposed Rule will potentially achieve the dual objectives that gave rise to the BIC: providing more "flexibility" for small plans that seek advice, while establishing protections to ensure that the advice they receive complies with the fiduciary standard.

In response to the DOL's request for comment, and to further harmonize the Proposed Rule, we believe it would also be appropriate to expand the BIC exemption to cover advice to plan sponsors of **participant-directed** plans with fewer than 100 participants. There does not appear to be a rationale for treating participant and non-participant directed plans differently under the BIC exemption. Further, the small participant-directed plans may also benefit from the resulting access to advice from an adviser that is subject to the BIC safeguards. As indicated in the Release, the advice could address the composition of the menu of investment options that the plan sponsor chooses to make available to plan participants—an important decision that has a significant impact on plan participants and their beneficiaries.[82]

D. DOL should provide that any violation of the BIC exemption not only gives rise to a cause of action for breach of the contract, but also nullifies the exemption.

The BIC exemption would require advisers to comply with a number of duties and prohibitions designed to mitigate the impact of the conflicts of interest that arise from commission-based and similar forms of compensation. In general, the exemption provides that a breach of those requirements results in multiple consequences: loss of the exemption, regulatory enforcement liability, liability for breach of contract, and, where plans are concerned, liability under the ERISA provisions creating a private right of action.[83] This is appropriate and necessary to ensure compliance with the terms of the exemption.

However, in two instances, the Release explains that breach of the applicable duty only leads to liability for breach of contract, not loss of the exemption. The Proposed Rule should be revised to make clear that a breach of any of the BIC exemption requirements will lead to loss of the exemption, in addition to liability for breach of contract.

First, the proposal would require advisers to warrant that they and their affiliates will comply with all applicable federal and state laws regarding the rendering of investment advice; the purchase, sale, or holding of assets; and the payment of compensation related to the purchase, sale, or holding of assets.[84] The Release further explains that the actual "failure to comply with such applicable federal and state laws" would not result in loss of the exemption, only contractual liability for breach of warranty, as long as the breach did not involve a violation of one of the exemption's other conditions (e.g. the best interest standard).[85]

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82 *Id.*
83 *See, e.g.*, 29 U.S.C. § 1132(a)(2), (3) & § 1109(a).
84 Release at 21970.
85 *Id.*

The BIC exemption should be strengthened to ensure that violations of the warranty to comply with applicable federal or state laws would result in loss of the exemption, in addition to liability for breach of contract. The basic commitment to comply with applicable federal and state law in connection with an advisory transaction is an important one, and advisers should be incentivized to comply with it no less than the other mandates in the BIC exemption.

Second, the proposal would require a financial institution to warrant that "it has adopted written policies and procedures that are reasonably designed to mitigate the impact of material conflicts of interest that exist with respect to the provision of investment advice to Retirement Investors and ensure that individual Advisers adhere to the Impartial Conduct Standards."[86] Here too, the Release observes that while the warranty must be included in the contract, "the exemption is not conditioned on compliance with the warranty."[87]

The BIC should be strengthened to ensure that violation of the warranty regarding adoption of policies and procedures nullifies the exemption, rather than simply giving rise to contractual liability for breach of warranty. The development of policies and procedures is a central component of the BIC exemption. It will be instrumental in making sure that advisers seeking to benefit from the exemption are properly mitigating conflicts of interest and are complying with the all-important Impartial Conduct Standards. An adviser's failure to adopt the required policies and procedures is a clear indication that the adviser cannot be counted on to abide by the conduct standards that are a prerequisite for reliance on the BIC exemption. To adequately incentivize compliance, this warranty must be fully enforceable, not only in a private action for breach of contract, but also as a matter of regulatory enforcement through loss of the exemption and any applicable statutory private rights of action.

E. DOL should prohibit the use of mandatory pre-dispute arbitration clauses.

An important feature of the BIC exemption is that it creates a new remedy for investors who have suffered damages from a violation of the contract, including a breach of the obligation to provide advice in the client's best interest. This is especially significant for IRA owners, who currently have no recourse when harmed by conflicted advice. Meaningful enforcement mechanisms, both private and governmental, are essential under any regulatory framework. Without them, even the most powerful set of conduct standards cannot adequately protect investors.

The BIC correctly prohibits contract terms that would require an investor to waive the right to bring or participate in a class action in court for violations of the contract. However, the proposal would allow advisers to insist that clients enter pre-dispute binding arbitration agreements. This provision largely nullifies the benefits of making the contract enforceable, and it should be changed: If an investor is harmed by violations of the contract,

[86] *Id.*
[87] *Id.*

such as a breach of the obligation to provide advice in the client's best interest, then that investor should have the right to seek remedies in court.

Allowing advisers to foreclose access to the courts through mandatory arbitration conflicts with one of the primary objectives of ERISA. In the statutory declaration of policy, Congress clearly expressed a desire to facilitate, not inhibit, an investor's ability to seek redress in court. That declaration expressly provides that the law is designed to protect plan participants and beneficiaries by "establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and **ready access to the Federal courts.**"[88] This alone is a compelling reason to change the Proposed Rule and expressly prohibit the use of mandatory arbitration clauses under the BIC exemption.

The approach in the Proposed Rule not only limits access to the courts, it also consigns retirement investors to an alternative that is a terribly deficient dispute resolution mechanism: arbitration. In its RIA, the DOL acknowledges the flaws in arbitration and observes that a prohibition against mandatory arbitration "might be an important and needed consumer protection."[89] Indeed, the DOL notes that a forthcoming study "characterizes such agreements as 'a dispute resolution system that lacks transparency, requires the investor to relinquish certain Constitutional rights and lacks any effective mechanism to correct erroneous decisions.'"[90] However, the DOL yields to uncertainty about the costs and benefits of this approach and adheres to the BIC provision allowing firms to force arbitration upon their clients.

This is the wrong approach. Just as the DOL is leading by moving forward with a strong Proposed Rule to better protect retirement investors with the fiduciary duty, it should also lead by rejecting the industry's insistence on the right to force clients into binding arbitration. The problems with arbitration are well known. Financial firms uniformly insist on binding arbitration clauses because it serves their interests. The process has been a disaster for investors, and a boon to Wall Street.

As noted in the Release, many if not most arbitrations under the BIC would be subject to FINRA's arbitration procedures.[91] Yet the FINRA arbitration forum has never fulfilled its promised role as a fair, expedient, and inexpensive method of redress. On the contrary, it is grossly deficient. It is unfairly skewed toward firms, as panels tend to favor industry; it offers low prospects for success, as even a "win" for the investor typically means a monetary award that falls well short of investor harms and attorneys' fees; and under federal law, it provides extremely limited avenues for appeal, even when significant unfairness or injustice has occurred in the process. Moreover, it does not actually provide investors with the often touted benefit of an "inexpensive" forum for dispute resolution. Firms are invariably

88 29 U.S.C. § 1001.
89 RIA at 207.
90 RIA at 207, quoting William Alan Nelson II, *Take It or Leave It: Unconscionability of Mandatory Pre-Dispute Arbitration Agreements in the Securities Industry*, 17 U. PA. J. BUS. L. 573, 599 (2015).
91 Release at 21973.

represented by seasoned attorneys, forcing investors to retain their own experienced counsel and incur substantial expense.

It is widely believed that FINRA's arbitration panels are biased in favor of brokerage firms. Many practitioners have explained that those who serve on the arbitration panels have "become beholden to the big firms. For them, it's a living. So they want to make sure their bread is buttered on the right side. They tend to favor the firms because they want to keep getting jobs."[92] Another practitioner notes that,

> There are arbitrators whose agenda is to continue to serve in these very cushy, prestigious roles. They know that if they issue an award against a firm, they're not going to be sitting in the future. It's an inherent systemic bias from having basically a trade organization administer arbitration. That's unique to the securities industry. The system doesn't smell right. But the firms don't want to change it.[93]

There is evidence that FINRA acts to preserve this bias when panels issue awards in favor of investors. This appears to have been what occurred in 2011. That year, a panel of three arbitrators granted a $520,000 award against Merrill Lynch.[94] Over the course of the next twelve months, FINRA removed all three from the roster of potential arbitrators. In response to an outcry from the investment community,

> [O]n July 25 [2012] the organization took the remarkable step of reinstating all three arbitrators to the FINRA roster. In a letter to the arbitrators, Linda Fienberg, the president of FINRA's dispute resolution and its chief hearing officer, explained that "after reading the commentary" from Bloomberg View she and her fellow FINRA executives "re-opened the matter."[95]

While these arbitrators were reinstated, there is no reliable count of the arbitrators who may have been removed for investor-friendly awards yet never reinstated. It is no surprise, then that the "win rate" for investors in FINRA arbitration was only about 38 percent in 2014, down from 42 percent in 2013.[96] And this "win" rate deceptively includes

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92 Quotation of Erwin Shustak, *FINRA's 'Total Warfare' Against Brokers in Arbitration*, THINKADVISOR (May 20, 2014), *available at* http://www.thinkadvisor.com/2014/05/20/finras-total-warfare-against-brokers-in-arbitratio. The full quote continues, "I see some names over and over again. Some people are 85 years old. I've been in arbitrations where panelists fall asleep after lunch. I have to drop a book on the table to wake them up. They have no idea what's going on."

93 Quotation of Dan Solin, *Id.* Additionally, "There is a big institutional bias," says Ed Gartenberg, of Gartenberg Gelfand Hayton & Selden, a securities litigation firm in Los Angeles. "The sum total is that the system greatly favors the brokerage houses. FINRA is an organization that's run by the brokerages — therefore, the arbitration is not on a level playing field."

94 William D. Cohan, *Cohan: Time to shut down Finra's arbitration panels*, InvestmentNews (July 30, 2012), *available at* http://www.investmentnews.com/article/20120730/FREE/120739999/cohan-time-to-shut-down-finras-arbitration-panels.

95 *Id.*

96 FINRA, *Dispute Resolution Statistics, Summary Arbitration Statistics June 2015, available at* http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics.

any award for the investor, regardless of how small in relation to the actual harm suffered or the attorneys' fees incurred.

The process also suffers from a lack of transparency. Typically, there is no publicly available award explaining the outcome, to serve as a guide for other investors and a deterrent against abuses by firms. Moreover, if an investor's complaint is settled before or during the hearing, it is likely that other investors will never hear about it. While FINRA runs the website BrokerCheck that highlight some elements of a broker disciplinary history, settled cases have long been expungeable:

> Critics of Finra policies also say many brokers are simply purchasing a clean record by offering substantial money in return for the customer's agreement not to oppose an expungement request. If a broker seeks expungement after reaching a confidential settlement with a customer, Finra says arbitrators must review the settlement documents and hold a recorded hearing. When arbitrators meet to consider a request, they typically only hear the broker's side of the story, making it easier to conclude that accusations are false or erroneous.[97]

With the expungement of these records, other potential clients received incomplete information about an adviser's disciplinary history and allegations of misconduct that have been leveled against them.

The arbitration process also deprives investors of a meaningful right of appeal. In state court, if the judge errs in some way, an appeal is always available to assess the lower court's ruling, including its findings of fact and conclusions law. However, under the Federal Arbitration Act, arbitrations may only be overturned in the rare case where an investor can show, for example, that corruption, misconduct, or a material "miscalculation of figures" occurred.

By contrast, mistakes of law—even egregious ones—are not among the enumerated grounds for appealing an arbitration awards.[98] A journal article referenced by the DOL in its RIA explains just how difficult the appeal process can be. Failing to consider all evidence presented, or even failing to force disclosure of all evidence, is not sufficient to have an award overturned.[99]

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97 Susan Antilla, *A Rise in Requests From Brokers to Wipe the Slate Clean*, THE NEW YORK TIMES (June 10, 2013), *available at* http://dealbook.nytimes.com/2013/06/10/a-rise-in-requests-from-brokers-to-wipe-the-slate-clean/

98 9 U.S.C. §§ 10, 11.

99 William Alan Nelson II, *Take It or Leave It: Unconscionability of Mandatory Pre-Dispute Arbitration Agreements in the Securities Industry*, 17 U. PA. J. BUS. L. 573, 604 (2015), *noting Nat'l Cas. Co. v. First State Ins. Group*, 430 F.3d 492, 497 (1st Cir. 2005) ("the First Circuit held that there was no misconduct when the arbitration panel issued the award without forcing the defendant company to produce relevant documents, because the arbitration panel acted within its authority when it chose to render a decision after drawing inferences against the company as to what documents would show.")

The arbitration system under FINRA is deemed so flawed that Congress expressly granted the SEC authority to eliminate mandatory arbitration clauses. Section 921 of the Dodd-Frank Act allows the SEC to prohibit or impose conditions or limitations on mandatory pre-dispute arbitration clauses by broker-dealers. Legislative history explains the serious concerns about arbitration that prompted Congress to act:

> For too long, securities industry practices have deprived investors of a choice when seeking dispute settlement, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms contend that arbitration is fair and efficient as a dispute resolution mechanism.
>
> Critics of mandatory arbitration clauses, however, maintain that the brokerage firms hold powerful advantages over investors. Brokerages often hide mandatory arbitration clauses in dense contract language. Moreover, arbitration settlements generally remain secret, preventing other investors from learning about the performance of a particular brokerage firm.
>
> If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court, should they view that option as superior to arbitration. For these reasons, H.R. 3817 provides the SEC with the authority to limit, prohibit or place conditions on mandatory arbitration clauses in securities contracts.[100]

By allowing mandatory arbitration, the DOL is not only restricting access to the courts in conflict with Congressional intent, it is also casting investors into an alternative system that deprives them of a fair hearing, limits transparency, and cuts them off from a meaningful right of appeal. The DOL must prohibit mandatory arbitration clauses.[101]

ARGUMENTS AGAINST THE PROPOSED RULE ARE BASELESS.

Industry opponents of the Propose Rule have relentlessly attacked the DOL's rulemaking effort, with a host of misconceptions, dire warnings, and even false allegations. These advocates largely represent the brokerage and insurance segments of the advisory industry that are fighting desperately to preserve their right to take advantage of their clients under the current DOL rule, and reap the outsized profits that come with that right. Their claims are baseless.

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[100] House Committee on Financial Services on H.R. 3817, H.R. Rep. No. 111-687, Part 1, at 50; 111th Congress's House Financial Services Committee report on H.R. 3817, The Investor Protection Act of 2009 and the precursor legislation to much of Title IX of the Dodd-Frank Act,

[101] We note that the FINRA Code of Arbitration does not require arbitration, but merely permits it. *See* FINRA Rule 12200, Code of Arbitration Procedure for Customer Disputes ("Parties must arbitrate a dispute under the Code if: Arbitration under the Code is either: (1) Required by a written agreement, or (2) Requested by the customer; ..."). As such, the Department's prohibition of mandatory arbitration clauses would not conflict with FINRA's rules for broker conduct.

1. The Proposed Rule will help, not hurt, low and middle income investors.

Many opponents argue that extending the fiduciary duty broadly and fairly to all advisers will raise costs and thus reduce the availability of their financial advice, to the detriment of low and middle income savers. This claim is baseless for many reasons. The Proposed Rule will not deprive small savers of valuable financial advice.

First, the argument is misleading. In reality, large brokerage firms currently do not really serve small account holders. For instance, "[m]any of the larger brokerage firms possess minimums of $100,000 to $250,000 to work with a broker, face-to-face."[102] In short, the Proposed Rule cannot possibly induce firms to abandon investors if those firms don't serve those investors in the first place.

In addition, evidence shows that the imposition of a fiduciary duty on brokerage firms and others does not in fact cause them to abandon their clients. One study demonstrates that the application of a fiduciary duty to broker-dealers has little, if any, effect on the availability of investment advice to clients, including those with moderate levels of income or assets.[103] That, of course, makes sense: Even if a business cannot extract excessive profits by acting on conflicts of interest, it does not follow that it will not "settle for" making reasonable compensation for providing conflict-free advice.

On a more fundamental level, this attack rests on a false premise. In general, conflicted investment advice is not more affordable than fee-based fiduciary advice, when all costs, fees, and inferior investment returns are factored in. The stark reality is that conflicted advice is not worth preserving in the marketplace. If some brokers and insurance agents cannot tolerate an environment where they are required to place their clients' interests ahead of their own, so be it. Investors will be better off.

Finally, even if brokers or insurance agents find they cannot serve small savers under the best interest standard, other advisers are eager to fill the void. For years, many advisers have embraced the fiduciary duty and are working with modest savers and small businesses to provide them with advice under the best interest standard while charging reasonable fees. In addition to those traditional advisers, a new generation of innovative advisory firms—including, for example, Rebalance IRA, Wealthfront, Personal Capital, and Financial Engine—is emerging that uses technology to reach more workers and retirees with low-cost, high quality advice as fiduciaries.

Since the inception of financial regulation in the United States, bankers, broker-dealers, and other members of the financial services industry have issued dire warnings that regulation will choke the life out of our financial markets, and hurt consumers. Yet the industry has not only adapted to new regulations again and again, but has thrived in the process. Whenever profitable opportunities arise, then other market participants enter the

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[102] Ron Rhoades, *Wall Street's Complaints About DOL Fiduciary Rulemaking Don't Withstand Scrutiny* (Feb. 23, 2015), *available at* http://scholarfp.blogspot.com/2015/02/wall-streets-complaints-about-dol.html.

[103] Michael Finke & Thomas Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice* (Mar. 9, 2012), *available at* http://ssrn.com/abstract=2019090.

market, fill the otherwise unmet need, and reap the profits. Entry has been a hallmark of our financial markets from the beginning and there is no legitimate reason to believe that will change under the Proposed Rule.

2. The DOL must not be required to wait for the SEC to address flaws in its own standards governing securities advice.

Some from the industry, including the Financial Industry Regulatory Authority (FINRA), have argued that the SEC should lead the rulemaking effort on strengthening the fiduciary duty for financial advisers. This suggestion is misguided for several reasons. It has no legal or policy rationale, and it is essentially a tactic aimed at delaying and ultimately derailing the DOL's Proposed Rule.

First, the DOL, not the SEC, was tasked by Congress with administering ERISA. It has the primary responsibility for protecting retirement assets and establishing rules for those who give retirement investment advice. Congress recognized the uniquely important role of retirement assets, giving them preferential tax treatment and protecting them through the highest possible standards of care and loyalty. The SEC simply has no authority to promulgate or amend any rules under ERISA. SEC Chair Mary Jo White has clearly acknowledged the separate mandates under which DOL and the SEC operate. Testifying before the Senate Financial Services and General Government Appropriations Subcommittee, she noted that the DOL and SEC "are separate agencies with separate statutory mandates," and the DOL rule proposal relates to its "important" mandate under ERISA.[104]

Further, the SEC only regulates transactions in securities. Yet, retirement accounts often include a variety of other, non-securities investments, including insurance products and commodities. The SEC cannot write a rule that adequately protects retirement account owners from conflicted advice when it comes to those types of assets, but the DOL can, as its authority extents to "any moneys or other property" of a plan.[105]

It is also a matter of record that the DOL has consulted extensively with the SEC, at both the leadership and staff levels, to ensure that its Proposed Rule is informed by the SEC's expertise and that the DOL proposal does not create conflicts with any aspect of the SEC's regulatory regime.

In reality, the effort to forestall the DOL rulemaking pending action by the SEC is nothing more than a delay tactic. For years, many advisers under the SEC's jurisdiction have been subject to a much weaker suitability standard, not a fiduciary duty, even when they provide securities investment advice. The SEC has been considering imposing the fiduciary standard on these advisers for decades, but has failed to act. SEC Chair White recently commented that the SEC is just beginning to consider whether and how to proceed with a

[104] U.S. Senate Committee on Appropriations, FSGG Subcommittee Hearing: FY16 Budget Requests for the SEC and CFTC (May 5, 2015), *available at* http://www.appropriations.senate.gov/webcast/fsgg-subcommitteehearing-fy16-budget-requests-sec-cftc.

[105] 29 U.S.C. § 1002.

new fiduciary duty rule for broker advisers. The DOL, on the other hand, has worked for years to write a strong proposed rule, far ahead of the SEC timeline. Thus, as a practical matter, forcing the DOL to wait for the SEC to act means years of delay. Workers and retirees cannot afford to wait, as their retirement savings are being depleted by conflicts of interest every day.

3. The regulatory approach adopted in the United Kingdom and contemplated elsewhere squarely supports the Proposed Rule.

Many opponents of the Proposed Rule cite reforms recently adopted in the United Kingdom as evidence that limits on commission compensation will reduce the availability of investment advice. But the comparison is flawed on two grounds: First, the UK rule is very different from the DOL proposal, and second, the UK rule has not in fact limited investor access to advice. On the contrary, advisers have adapted, investment products are cheaper and more transparent, and investment advice is not tainted by the conflicts of interest stemming from the lure of commissions.

Like retirement savers in the U.S., investors in the UK have suffered from losses due to pervasive conflicts of interest that incentivize advisers to put their own interests ahead of their clients. To address this problem, the Financial Conduct Authority (FCA) in the UK issued regulations effective January 1, 2013, known as the Retail Distribution Review (RDR). The RDR eliminated commission-based business models applying to all investment products, not just retirement accounts.

The RDR and the DOL proposals are very different. In contrast with the RDR, the DOL proposal does not abolish commission based compensation. In fact, the DOL proposal allows broker-dealers, insurance agents, and other advisers to continue to be paid through commissions and similar forms of compensation, provided they act in their clients' best interest and comply with the other safeguards under the BIC exemption.

What is striking is that even the complete ban on commission compensation has not limited investor access to affordable investment advice in the UK. Research by the FCA has shown that the number of advisers serving investors at all income levels has risen since the end of 2012.[106] Moreover, although there were instances in which some banks withdrew from the advice market, "It would be wrong to ascribe all of the withdrawals from the market to the RDR."[107] In fact, the supply of advisers willing to serve the serve medium and smaller accounts is more than sufficient to meet the needs of UK investors.[108]

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[106] Letter from David Geale, FCA, UK, to Joseph Piacentini, U.S. Department of Labor (2014), *available at* http://www.dol.gov/ebsa/pdf/conflictsofinterestreport7.pdf

[107] *Id.*

[108] Tom Rampulla, *When the advice industry changed at warp speed,* VANGUARD BLOG FOR ADVISORS (July 6, 2015), *available at* http://vanguardadvisorsblog.com/2015/07/06/when-the-advice-industry-changed-at-warp-speed/.

4. The Proposed Rule will not create overwhelming litigation liability.

Some in the industry have claimed that the Proposed Rule will trigger an onslaught of litigation, threatening potentially devastating liability. This is unfounded. As a threshold matter, Congress clearly intended retirement savers to have meaningful remedies in court when ERISA fiduciaries violate applicable standards of conduct. The Congressional declaration of policy in ERISA expressly provides that the law is designed to protect plan participants and beneficiaries by "establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, **and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.**"[109]

Apart from legislative intent, the Proposed Rule embodies an important limitation based on the nature of the inquiry that will determine an adviser's liability: As explained in the Release, recommendations are assessed for compliance with the best interest standard based on the circumstances prevailing at the time advice is rendered—not based on future performance of the product sold.[110] This limits the opportunity for any investor to seek unfair redress for losses that arise from market performance rather than adviser misconduct.

In addition, the proposed BIC exemption allows advisers to force their clients into mandatory arbitration clauses.[111] If this provision becomes final, then advisers have little to fear from litigation under the Proposed Rule. As explained above, the arbitration forum favors industry and dampens the frequency and magnitude of recoveries by investors.

While the Proposed Rule would preserve the right of an investor to bring or participate in class actions, this right would not pose a significant liability threat to advisers. For years, procedural hurdles have made class action lawsuits a difficult undertaking. For example, they cannot be brought where the particular facts and circumstances surrounding each investor's claims must be individually analyzed—as in typical cases involving breach of fiduciary standards. On the other hand, if an adviser were to engage in the type of systemic misconduct under the final rule that would lend itself to class action resolution, then it would be highly appropriate—not an unfair burden—for investors to have recourse via a class action suit.

Finally, industry's predictions about litigation liability also lack empirical support. Advisers who already abide by the best interest standard have not been subject to unreasonable litigation liability.

By raising the specter of burdensome litigation, opponents of the Proposed Rule are in effect saying that they refuse to be accountable. This is no reason to reject or weaken the Proposed Rule. Litigation is an appropriate and necessary mechanism for allowing victims of misconduct, including breaches of the fiduciary duty, to obtain fair redress for their damages. The simple solution to fears about litigation is for an adviser to comply with the

[109] 29 U.S.C. § 1001.
[110] Release at 21970.
[111] Release at 21973.

regulatory standards that govern his conduct for the protection of investors. If an adviser either cannot or will not adhere to those standards, the appropriate response is to deny them the privilege of being an adviser, not dilute the rule.

5. A disclosure regime is no substitute for an affirmative fiduciary duty to put the client's interest first.

Opponents of the Proposed Rule have also argued that an enhanced disclosure regime can cure the defects in the current DOL rule and adequately protect investors from conflicts of interest. However, the DOL's RIA, as well as years of independent studies, note that "disclosures often fail to make investors aware of their advisers' conflicts, let alone understand their nature and potential implications." The RIA cites several studies finding that "for many investors, the fact that they were given disclosures was seen as meaningless," and that disclosure can even "backfire" because advisers feel they may act outside of their clients' interest so long as their clients have been warned.

But even if disclosures could somehow be made flawlessly clear, timely, and intelligible, they would fall far short of what retirement savers need and what Congress intended in ERISA. As quoted above, Congress recognized that to adequately protect investors from the powerful conflicts of interest that often arise among advisers, the establishment of affirmative duties and proscriptions were essential. In fact, throughout ERISA, Congress recognized the need to impose conduct standards **in addition to mandatory disclosures.** The declaration of policy alone repeatedly articulates the goals underlying the statute: that "safeguards be provided" in addition to disclosures; "that minimum standards be provided;" and that "standards of conduct, responsibility, and obligation for fiduciaries" be established.[112]

Thus, relying on disclosures to cure the problems in the DOL's outdated rule would conflict with Congress's clear intent in enacting ERISA. Worse, it would leave investors at the mercy of advisers who, having gone through the disclosure ritual, would be free to put their own interests ahead of what's best for their clients. The status quo would persist, and millions of retirement savers would continue to be victimized. Disclosure is an unacceptable alternative to a strong, broadly applied fiduciary standard.

[112] 29 U.S.C. § 1001.

CONCLUSION

We again commend the DOL for moving forward with the Proposed Rule. It will dramatically improve the ability of millions of American workers and retirees to save and invest for a dignified retirement. We urge you to resist calls for changes in the proposal that will dilute the protections it offers, and to finalize it with the enhancements described above as soon as possible.

Sincerely,

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STATEMENT OF BETTER MARKETS IN SUPPORT OF THE DEPARTMENT OF LABOR'S PROPOSED CONFLICTS OF INTEREST RULE

DELIVERED AT THE
PUBLIC HEARING SESSION
HELD ON AUGUST 11, 2015

BETTER MARKETS
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Good afternoon, my name is Stephen Hall and I'm testifying today on behalf of Better Markets. Better Markets is a non-profit, non-partisan, and independent organization established in the wake of the 2008 financial crisis to promote the public interest in the financial markets, to support the financial reform of Wall Street, and to make our financial system work for all Americans.

We appreciate the opportunity to address one of the most important regulatory initiatives in the past 40 years aimed at improving Americans' retirement security.

The DOL has developed an excellent rule that will provide retirement savers with much stronger protections against the damaging conflicts of interest that have been allowed to persist among financial advisers for decades. We commend the DOL for its proposal, and we strongly support it.

At this point in the debate, it is settled that gaps in the DOL's 40-year old rule have created a flawed system, one that allows advisers to put their own interests ahead of their clients. While not all advisers take advantage of this system, far too many do. It is also settled that workers and retirees are suffering terrible losses as a result. By conservative estimates, the damages add up to tens of billions of dollars a year. The focus now is on industry arguments designed to defeat or weaken the rule.

At this hearing, I'd like to address several misconceptions that industry opponents have disseminated about the rule. Then I'll close by highlighting one of the single most important ways the DOL can strengthen its proposal.

FIRST, opponents of the rule have fostered the misconception that the DOL's proposal is a radical new approach that deviates from the law.

In reality, however, the DOL's proposal is a measured and reasonable effort to close loopholes that never had any statutory basis and to bring its rule into better alignment with what Congress actually said and always intended in ERISA.

ERISA's definition is clear and simple: It provides that a person becomes a fiduciary by rendering investment advice for compensation with respect to retirement plan assets. Yet, in 1975, the DOL issued a rule that deviated substantially from this definition and added elements that had no statutory basis. For example, advice is subject to the fiduciary duty only if it is given regularly and only if it serves as the primary basis for an investor's decision. These elements have thwarted the DOL's ability to protect retirement savers from conflicts of interest as Congress intended.

The DOL's new proposal eliminates these loopholes. In addition, the proposal expressly covers recommendations to take a distribution of plan assets. That's a critical juncture in the life of most retirement savers, when the protections of the best interest standard are more important than ever.

With these basic modifications, the DOL has vastly improved upon its current rule not by stretching the boundaries of ERISA but by more faithfully implementing its letter and spirit.

SECOND, industry opponents have complained that the rule prohibits established compensation models unless advisers comply with an allegedly burdensome and complex exemption.

In fact, advisers have no entitlement to preserve their conflicted compensation models under the law, and the DOL's exemption is appropriately conditioned on reasonable and necessary safeguards.

There is no question that commission-based compensation creates impermissible conflicts of interest under ERISA. The DOL's decision to offer an exemption allowing those models to persist is an accommodation, not an entitlement. And while the Best Interest Contract exemption imposes a variety of conditions on the privilege of receiving commissions, that is what the law requires: Under ERISA, the DOL may not create prohibited transaction exemptions unless they protect the interests of plans and plan participants.

In short, advisers who currently receive commissions have three choices: They can comply with the reasonable conditions of the Best Interest Contract Exemption; they can change their fee structures to eliminate such conflicts of interest; or they can stop providing retirement investment advice altogether. Under any of these scenarios, investors and plan sponsors will be far better off, free from the conflicted advice that has victimized them for decades.

And we will see no advice gap whatsoever. Contrary to their alarmist predictions, brokers and insurance agents are almost certain to adjust to the new rule rather than withdraw their services. That's been the pattern with

every major financial reform in the last century: dire warnings about upheaval in the financial sector followed by adaptation and ever-growing profits on Wall Street.

More importantly, if those advisers really do abandon their clients, an established and growing population of fiduciary advisers stands ready, willing, and able to serve all retirement savers regardless of account size. And they will do so under very affordable fee structures.

THIRD, industry opponents have argued that we should rely on the SEC to address the gaps in the standard of loyalty applicable to advisers.

This argument has no basis, and it's being advanced solely to defeat or delay the DOL's rule. The SEC has no legal authority to issue or update any rules implementing ERISA. Congress gave that responsibility to the DOL, recognizing the unique importance of tax-advantaged retirement assets and the need to protect them under a separate regime applying the highest possible standards of loyalty and care.

Furthermore, the SEC lacks any authority to regulate advice about investments that are not securities. Yet, retirement accounts routinely include a variety of non-securities investments, including insurance products and even commodities. Unlike the SEC, the DOL has broad authority over these assets as well as any "moneys or other property" of a plan.

Nothing in Section 913 of the Dodd-Frank Act changes this assessment. Section 913 contains no suggestion that Congress intended the SEC's authority to take precedence over DOL's regulation of retirement investment advice. On the contrary, in Section 913, Congress could have taken the opportunity to subordinate the DOL's authority or link it in some way to the SEC's oversight, but it chose not to.

As a practical matter, forcing the DOL to wait for the SEC means indefinite delay, lasting years at a minimum. The SEC is just beginning to decide whether it should embark on a rulemaking to enhance adviser standards under the securities laws. The agency is still mired in indecision, even though five years ago, Congress expressly authorized it to act and the SEC's own staff strongly recommended that it move forward with a rule. Workers and retirees cannot afford to wait any longer, as their retirement savings are being depleted by conflicts of interest every day.

FINALLY, the DOL can make the rule even stronger by prohibiting the use of mandatory arbitration clauses.

Without meaningful private remedies, even the most powerful set of conduct standards cannot adequately protect investors.

However, under the proposed Best Interest Contract Exemption, advisers can insist that clients enter pre-dispute binding arbitration agreements, thus limiting an investor's right to seek remedies in court. This provision should be eliminated for two reasons.

First, it is not what Congress intended. In the ERISA Declaration of Policy, Congress expressly stated that its goal was not only to establish standards of conduct, but also to provide **"ready access to the Federal courts"** so that plan participants could seek appropriate remedies. In accordance with that policy, the statute gives plan participants the right to file actions in federal court for violations of the fiduciary duty.

Second, allowing advisers to insist on arbitration leaves investors with a terribly inadequate substitute for judicial remedies. As the DOL has noted, many arbitrations under the Best Interest Contract Exemption would be subject to FINRA's arbitration process. Unfortunately, that system is a grossly deficient dispute resolution mechanism. Consider just the most obvious defects:

1. It is not a fair process, as even the so-called "public" arbitrators are allowed to have had extensive careers in the financial industry;
2. It severely limits discovery, to the detriment of investors;
3. It does not require panels to actually apply the law or explain their awards;
4. It produces awards that typically fall well short of actual damages and the attorneys' fees necessary to bring a claim; and
5. It provides extremely limited avenues for appeal, even when significant unfairness or injustice has occurred.

By favoring arbitration and raising the specter of burdensome litigation in the courts, opponents of the proposed rule are in effect saying that they don't want to be accountable. That's no justification for weakening the rule.

In closing, I'll reiterate our view that the DOL rule is an extremely important reform that will benefit millions of Americans saving for retirement. It should be finalized as soon as possible.

That concludes my statement and I look forward to your questions.

Statement for the Record

Joint Hearing of the
Subcommittees on Oversight and Investigations and
Capital Markets and Government Sponsored Enterprises on
"Preserving Retirement Security and Investment Choices for All Americans"

Chairman Jeb Hensarling
Ranking Member Maxine Waters
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

September 10, 2015

Dear Chairman Hensarling and Ranking Member Waters:

As you know, today's workers face challenges in achieving retirement security, with families largely on their own to make major investing and retirement planning decisions. Consequently, many turn to financial professionals to help chart a course for retirement.

However, such professionals are only a benefit if they provide the best advice for the saver, rather than for their own earnings. In other words, this advice must meet the highest standard for relationships of trust: a fiduciary standard. Otherwise, as we have seen in the financial marketplace under the so-called suitability standard for retirement advice, savers and retirees face high fees and potential abuse.

Last month, I had the opportunity to testify before the Department about its proposed conflict of interest rule, a proposal that would truly put savers' and retirees' best interests first.[1] In this testimony, I noted that while a fiduciary standard would require market adjustments, giving conflict-free retirement advice is not unworkable, and small savers' needs could continue to be met. I would like to share with you the following excerpts from my testimony.

Unfortunately, the current suitability standard, which is four decades old, reflects a lower standard of care. It ignores the significant long-term consequences of even one-time advice and enables contracts to imply in fine print that these are not binding relationships of trust. As a result, broker-dealers and others are able to market themselves as financial advisers or consultants without actually complying with the rules that normally govern such relationships.

When families do turn to financial professionals, the suitability standard has major consequences for retirement savers through high fees and potential abuse. The market for IRAs is a prime example. Today, the $7.4 trillion in IRA assets even exceed those in 401(k) plans.[2] The vast majority of these funds come from rollovers when workers change jobs or retire. As the Government Accountability Office recently found, workers leaving a job who sought advice were often "highly encouraged" to convert to a high-cost IRA even if they could stay in their plan or move their savings to their new employer's plan.[3]

Even workers in the federal Thrift Savings Plan, or TSP—the lowest-cost plan imaginable—have been subject to marketing disguised as advice. Nearly half of all federal employees take money out of the TSP when they leave the government despite the fact that other plans have fees that are at least 20 times

higher.[4] These migrations are extremely costly as fees compound over time. Even a 75 basis point, or 0.75 percent, difference in fees for a young worker could result in $100,000 of additional fees across a lifetime. That's equivalent to working three additional years to achieve the same retirement income.[5]

What's more, conflicted advice often carries significant consequences beyond excessive investment and plan management fees. Consider Elaine and Merlin Toffel of Illinois, whose story was reported last year in The New York Times. After meeting with brokers at their trusted local bank branch, they sold a portfolio of low-cost investments—incurring tax consequences along the way—and invested most of their money in expensive variable annuities recommended by the bank, with a 4 percent annual fee and a 7 percent surrender charge for accessing funds early. The surrender fee made it difficult for the Toffels to use these assets to cover long-term care needs. An advisor acting in their best interest likely would have instead recommended modest investment changes.[6]

These abuses demonstrate the need for the Department of Labor's proposed rule.

While a fiduciary standard would require market adjustments, giving conflict-free retirement advice is not unworkable. Thirty million investors are currently served by registered investment advisers who manage $67 trillion under a legal obligation to serve the best interest of their clients.[7] And, increasingly, firms are using technology to offer advice under a fiduciary standard at a fraction of the cost of the conflicted advice available today. Rebalance IRA, for example, reports that the average new customer coming from a brokerage relationship previously incurred an average total fee exceeding 2.37 percent per year.[8] After becoming a Rebalance customer, customers' fees declined on average by 68 percent. In any other industry, this development would be called innovation or disruption, rather than being dismissed as so-called robo advice.

Many have argued that small savers' needs will no longer be met through the department's proposed rule.[9] As someone whose work focuses on consumer policies that support low- and moderate-income Americans, I disagree. Instead, I agree with Arthur Levitt, the former Securities and Exchange Commission Chairman, who recently stated that, "I think people of modest means are the ones who need this rule more than any other type of investor."[10] Industry warnings about losing access are often a red herring, as we have seen in efforts to restrict predatory or misleading credit products, such as high-cost mortgages and auto loans.[11] And when families cannot achieve a secure retirement, taxpayers collectively pay the price.

Some have also speculated that enhanced disclosures alone could address this need. Notably, the proposed Best Interest Contract Exemption, a safe harbor, contains several key disclosures that could potentially empower consumers to identify fees in a clear and comprehensible manner. CAP strongly supports prepurchase disclosures that illustrate the consequences of fees not just in one year, but also the effects of compounding over a 20-year period. And CAP also supports the development of a "Retirement Receipt," an annual disclosure of a retirement account's investment and administrative fees in dollar terms.[12]

Yet, if the proposed rule focuses only on disclosure—as some have argued it should—it will have missed the point. Additional information can help savers and retirees make comparisons and identify where their hard-earned dollars are going. But when savers enter into a perceived relationship of trust, they should not have to worry that their advisor is serving his or her own financial needs instead of their needs.

Thank you for providing me with the opportunity to discuss this matter. Please do not hesitate to contact me if you have any questions or would like any additional information.

Sincerely,

Joe Valenti
Director of Consumer Finance
Center for American Progress

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[1] Joe Valenti, "The Fiduciary Rule Would Put Savers' and Retirees' Best Interests First" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/08/12/119299/the-fiduciary-rule-would-put-savers-and-retirees-best-interests-first/.

[2] Investment Company Institute, "2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry" (2015), available at https://www.ici.org/pdf/2015_factbook.pdf.

[3] Government Accountability Office, "401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants," GAO-13-30, Report to Congressional Requesters, March 2013, available at http://www.gao.gov/assets/660/652881.pdf.

[4] John Hechinger, "Brokers Lure Soldiers Out of Low-Fee Federal Retirement Plan," Bloomberg News, August 12, 2014, available at http://www.bloomberg.com/news/articles/2014-08-12/brokers-lure-soldiers-out-of-low-fee-federal-retirement-plan.

[5] Jennifer Erickson and David Madland, "Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them" (Washington: Center for American Progress, 2014), available at https://www.americanprogress.org/issues/economy/report/2014/04/11/87503/fixing-the-drain-on-retirement-savings/.

[6] Tara Siegel Bernard, "Before the Advice, Check Out the Adviser," The New York Times, October 10, 2014, available at http://www.nytimes.com/2014/10/12/business/mutfund/before-the-advice-check-out-the-adviser.html.

[7] National Regulatory Services, "A Profile of the Investment Adviser Profession—Evolution Revolution 2015," available at http://www.nrs-inc.com/EvolutionRevolution2015 (last accessed August 2015).

[8] Rebalance IRA Managing Director Scott Puritz, "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees" Testimony before the Senate Health, Education, Labor and Pensions Committee, Subcommittee on Employment and Workplace Safety, July 21, 2015, available at http://www.help.senate.gov/imo/media/doc/Puritz.pdf.

[9] Robert Litan and Hal Singer, "Obama's Big Idea for Small Savers: 'Robo' Financial Advice," The Wall Street Journal, July 21, 2015, available at http://www.wsj.com/articles/obamas-bigidea-for-small-savers-robo-financial-advice-1437521976.

[10] U.S. Department of Labor, "Arthur Levitt: Move Forward on the Fiduciary Standard," YouTube, May 18, 2015, available at https://www.youtube.com/watch?v=7zycY3rn6pc.

[11] For example, see, Joe Valenti, Sarah Edelman, and Julia Gordon, "Lending for Success" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/07/13/117020/lending-for-success/.

[12] Jennifer Erickson and David Madland, "Retirement Labels and Retirement Receipts Could Save American Investors Billions Each Year," Center for American Progress, July 1, 2015, available at https://www.americanprogress.org/issues/economy/news/2015/07/01/115509/retirement-labels-and-retirement-receipts-could-save-american-investors-billions-each-year/.

Written Testimony Submitted To
House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises
Subcommittee on Oversight and Investigations
Hearing entitled "Preserving Retirement Security and Investment Choices for All Americans"
September 10, 2015

Chairman Hensarling and Ranking Member Waters,

I am writing to let you know that The Committee for the Fiduciary Standard supports the DOL fiduciary rulemaking.

I am writing in advance of Thursday's hearing on H.R. 1090, legislation introduced by Rep. Wagner that would force the Department of Labor to step aside in crafting new rules for the retirement investment marketplace and instead wait for the Securities and Exchange Commission to possibly take action sometime in the future. **We have had extensive meetings with SEC and do not believe they are going to take any action on the fiduciary standard – which is exactly why those oppose the rulemaking want to punt to SEC.** We know that many in the industry would like to continue to skirt fiduciary requirements in the DOL proposal and will say or do anything to kill it, or alternatively, water it down so as to be meaningless. In addition, rulemaking by the SEC will not cover insurance companies, which represent many of the most egregious examples of harm via, products laden with hidden, unreasonably high-commissions and high fees. They are sold under the disguise of advice when there is no such "advice" given, just scare tactics and browbeating, psycho-bullying of older Americans.

I am Kathleen M. McBride, an Accredited Investment Fiduciary Analyst® and a CEFEX Certification Analyst with the Centre for Fiduciary Excellence – CEFEX. I serve as Chair for The Committee for the Fiduciary Standard, an all-volunteer group of investment professionals and fiduciary experts, formed to advocate that all investment and financial advice be rendered as fiduciary advice and meet the requirements of the Committee's five core fiduciary principles. The Committee's work is pro bono.

I represent The Committee for the Fiduciary Standard for this testimony

We are challenging the status quo to ensure that all Americans can achieve a dignified, secure, retirement. I testify in support of this DOL Rulemaking. It is long overdue.

Thank you for the opportunity to testify today, about a strong fiduciary rule that will eliminate many conflicts of interest that harm America's retirement investors. Americans who work and sacrifice to save and invest for their retirement should not have their nest egg diminished by Wall Street broker/deales, banks, insurance companies and mutual fund companies. and insurance companies that place their own interests before the retirement investors they have the privilege of serving. Their short term greed ensures only one thing: that America's retirees will not have the spending power in retirement that they would have with advice that is in THEIR best interest. As you know, we have a retirement market today that works really well for the broker-dealers, and insurance companies, and mutual fund companies that reap billions of dollars in profits providing services to tax-subsidized retirement accounts. But it works a lot less well for working families and retirees – individuals with no particular financial sophistication – who struggle with complex decisions about how best to save and invest for and in retirement, and who bear the full risks when those decisions turn out badly.

We believe protections for working families and retirees need to be strengthened by requiring the financial professionals they turn to for retirement investment advice to act in their best interests.

The Department of Labor's conflict of interest rule proposal would achieve that goal by closing loopholes in the definition of fiduciary investment advice that allow firms to evade their fiduciary obligations. At the same time, the proposal eases restrictions on the types of compensation financial firms can receive so long as they abide by appropriate regulatory restrictions. Chief among these are

requirements to act in the best interests of their customer and avoid compensation and other practices that conflict with that goal.

The result is a balanced rule that provides much needed new protections for retirement savers while providing the flexibility necessary to enable well-meaning firms operating under a variety of business models to comply.

We urge you to reject any proposals, such as the "alternative" approaches advanced by various industry players that wouldn't make any meaningful changes in the way business is done today. The Department's proposed standard, which recognizes that best interest should set a higher bar than suitability and which backs that standard with real, meaningful mitigation of conflicts is absolutely consistent with the reasonable expectations of retirement savers when they turn to financial professionals for advice. It is the industry's "best interest" standard in name only that is fatally flawed.

We also urge you to reject HR 1090, which is the subject of Thursday's hearing. It is worth noting that, if the SEC eventually gets around to adopting a rule – something that is far from guaranteed, it would by definition be limited to recommendations regarding securities. It would not apply to recommendations of insurance products, which form an important part of the retirement market, or other non-securities investments that are sold to investors through retirement accounts. The irony is that the DOL has gone out of its way to incorporate securities law principles in its rule. The DOL definition of investment advice is virtually identical to the securities law definition. The best interest standard is borrowed directly from Section 913 of Dodd-Frank, where Congress identified "best interests, without regard to the financial or other interests of the adviser" as the standard that should apply if the SEC were to adopt rules under the securities laws. DOL even deals with issues related to ongoing duty of care and sales from a limited menu of proprietary products in ways that are consistent with the principles in Dodd-Frank. Indeed, the SEC could do far worse than to follow the DOL's lead if it does eventually get around to drafting a fiduciary rule for the securities markets.

Finally, **we would encourage you to ignore the industry argument that many brokers will simply stop serving this market if the rule is adopted and that investors, particularly small savers, will be harmed if they lose access to advice or are forced into more expensive fee accounts.** The reality is that there is no compelling evidence that brokerage accounts are consistently more affordable than fee accounts when the total cost of investing is taken into account. But the more fundamental point you need to keep in mind is that this is what the industry always says when faced with a rule they don't like.

We know the fiduciary model works very well, and has for several decades. Registered Investment Advisers (RIAs) already act as fiduciaries, providing advice and/ or investment management, in the investor's best interest, at a reasonable cost.

Registered Investment Advisers (RIAs) already serve investors of all account sizes, including retirement plans, and individual investors in retirement and non-retirement accounts. The DOL's proposal is workable. It is do-able. And, by the way, it is profitable.

RIA fiduciaries are advising millions of investors. They now advise or manage $67 Trillion, through more than 11,473 RIA firms. RIAs employ 750,000 individuals and serve 30 Million clients.

The Department of Labor's proposed rule will help ensure that, when workers and retirees turn to financial professionals for investment advice, they get real, objective advice and not just a sales pitch dressed up as advice. The proposed rule won't solve every problem with our retirement system, but it is very much worth fighting for. **We urge you to reject any efforts –whether through stand-alone legislation or through a policy rider on a spending bill –that would derail this initiative that is so critical to helping Americans keep more of their hard-earned money that they have saved and invested for a secure retirement.**

We applaud DOL for prohibiting a seller's exemption for retail investors – including IRA owners. DOL has proposed a rule in which the North Star of fiduciary obligation is paramount, including in any

exemptions.

Now we will finally close the unintended loopholes that enabled systematic taking of assets from America's retirement investors, for decades.

DOL has used its rulemaking authority to include IRA investors under this proposal, including advice on whether it is in their best interest -- or not -- to roll retirement plan assets from 401(k)-type plans into IRAs. This has been an area of particular, egregious harm, a wild west of abusive strategies by some industry entities to grab enormous amounts of retirement money from hard-working retirement investors, just as they will need this money the most.

When retirement investors are making the decision whether or not to roll retirement savings over to an IRA, they are at their most vulnerable. This fact is not lost on the non-fiduciary sales reps of banks, broker-dealers, insurance companies, and mutual fund companies. It is the subject of enormous planning, strategy and training at firms that seek to "capture" retirement investors' assets, along with unreasonably high commissions and fees.

And it is here that retirement investors are often caught off guard. As one behavioral economist (who as done much research on the effects of disclosures in adviser and investor behavior) points out;

"It is very hard to say "No" to the representative sitting at your kitchen table, even if you know that what they are telling you to do is NOT in your best interest."

An Example of Harm: Pension Rollover Solicitations

David Franklin (not his real name to protect his privacy), had just celebrated his 65th birthday. After college he joined the Navy, retiring as a lieutenant after his tour of duty. He entered the private sector. Over his successful career he accumulated a combination of traditional, defined benefit pension plans and 401(k)-type plans. Mr. Franklin worked hard to accumulate a retirement nest egg. He was a beneficiary of a two multibillion-dollar pension plans, which send retirees a monthly check, for life.

Shortly after his birthday, Mr. Franklin got a phone call from an "adviser" claiming to work with one of the traditional pension plans. He wanted to discuss Mr. Franklin's retirement situation. This "adviser" began by asking whether Mr. Franklin was confident he'd have enough to live on for the rest of his life.

This "adviser" insinuated that the (Fortune 40 and Fortune 15) companies with the traditional pension plans might go out of business, taking Mr. Franklin's monthly payment with them. What would Mr. Franklin do then?

This "adviser" strongly urged Mr. Franklin to take the lump sum payouts from his two pensions -- six-figures -- and put his money into a "guaranteed" annuity in an IRA at his major mutual fund company. Sure, it would pay Mr. Franklin ***several hundred dollars less every month*** than the pension plan would, "**but it would be guaranteed.**" He hounded Mr. Franklin until Mr. Franklin did, in fact, rollover one of his pension plans into an IRA at that major mutual fund company, ready for that annuity. And then Mr. Franklin called a friend. It is too late for Mr. Franklin to reverse his lump sum pension payout so he now has to find a way to replace the retirement income his pension would have provided -- for life.

While Mr. Franklin will not be taking any more "advice" from that "adviser," damage has already been done.

This happens every day, to thousands of America's retirement investors.
This is the model Wall St and Insurance special interests want to protect.

And Now, A Few Words About "Best Interest"

There are currently two very different interpretations of "Best Interest" being discussed, as various parties assert their views on this DOL rulemaking.

One is DOL's meaning, as stated on page 36 of the preamble to the proposal:

"As proposed, the best interest standard is intended to mirror the duties of prudence and loyalty, as applied in the context of fiduciary investment advice under sections 404(a)(1)(A) and (B) of ERISA. Thus, the "best interest" standard is rooted in the longstanding trust-law duties of prudence and loyalty adopted in section 404 of ERISA and in the cases interpreting those standards."

This definition must be indelible, untouchable, and undiluted. The North Star of Fiduciary Obligation that goes hand in hand with the privilege of serving retirement investors.

Lobby groups are floating the other version of "Best Interest":

Special interests lobbyists have stated they want a revamped "Best Interests" proposal from DOL. But, if you read or listen carefully, when they discuss "Best Interest," it's **NOT** about Best Interest of the investor! They want a Best Interest proposal that **is in the "Best Interest" of the broker-dealers and insurance companies**. One that's in the Best Interest of the Special Interests!

To put it another way, they want to preserve the status quo that allows them to continue to systematically exploit unintended loopholes in 40-year old ERISA regulation, and bleed retirement investors for every dollar they can grab.

We Know the Fiduciary Model Works: RIAs Already Act as Fiduciaries -- In their Clients' Best Interest

Registered Investment Advisers are already serving plans and retirement investors as fiduciaries, across all account sizes. **DOL's proposal is workable. It's doable, and, by the way, it's profitable.**

RIAs Are Advising Millions of Investors - They now advise or manage $67 Trillion through more than 11,000 (11,473) RIA firms. They employ 750,000 individuals, and serve 30 million clients. [1]

So much for the special interests' scare tactic, the claim that nobody will get any advice if DOL's fiduciary rulemaking goes through.

PS, The argument that nobody will get advice, if the DOL rulemaking proceeds is really very funny. In fact it is many things -- But it is not true. Brokers and insurance reps do not provide actual advice, especially on-going advice. They sell a security, one-time -- often under the guise of advice -- and reap an upfront commission and an ongoing annual fee – for doing nothing. Their firm may get a back door payment from an unwitting investor, too, for as long as the investor owns the security. But that's not advice. It is, however, the way broker-dealers and insurance companies deal with retirement investors. It's not advice. It's not a service. And updated DOL ERISA rules that prohibit those practices are *LONG OVERDUE.*

Let's Debunk Some of the Myths About the Fiduciary Standard for Retirement Advice

Myth #1 It Costs More to Get Advice From A Fiduciary

Opponents to the DOL proposal claim the fiduciary standard would raise costs to investors, and reduce access to advice and investment products.

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[1] Evolution Revolution – A Profile of the Investment Adviser Profession
https://www.investmentadviser.org/eweb/docs/Publications_News/EVREV/evolution_revolution_2015.pdf

That's not true, according to the latest fi360 Fiduciary Standard survey. It measures financial intermediaries' attitudes toward the fiduciary standard. It includes RIA/IARs, brokers, dually registered broker / adviser reps, and insurance reps.[2]

The survey asked, ***"Do you believe it costs more to work with fiduciary advisors than brokers, when all costs to the investor (not only the advisor's compensation) are considered?"***

Nearly 91% of respondents say no -- it does not cost more to work with a fiduciary adviser than with a broker.

Many of the comments from survey respondents indicate that, **instead of a higher cost for the investor to work with a fiduciary adviser, *it actually costs investors less to work with a fiduciary.*** There is much academic research that supports this finding.[3] [4] [5]

Myth #2 It Would Cost Us Too Much to Provide Fiduciary Advice; We'd Have to Pass Those Costs Along to Investors

The survey asked: ***"Do you believe a fiduciary standard of care would price some investors out of the market for investment advice?"***

Survey respondents say, **no it would not**. Eight out of ten, **83%, say no, the fiduciary standard would not price some investors out of the market for advice.**

Myth #3 If We Are "Forced" to Provide Advice That's in the Investor's Best Interest, We Will Abandon Retirement Investors

Opponents of the fiduciary standard claim products and services would be reduced for investors, if brokers were required to act as fiduciaries. What they *really* mean is, if they had to act as fiduciaries, they couldn't sell the high risk, high commission products they sell now, because those would not be in the investor's best interest. And remember, brokers and insurance reps don't provide advice now, certainly not to smaller investors.

The survey asks: ***"Do you believe a fiduciary duty for brokers who provide advice would reduce product and service availability for investors?"***

A majority of 78% says no, fiduciary duty for brokers who provide advice would not reduce product or service availability for investors.[6]

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[2] There have been four surveys, 2011, 2012, 2013 and 2015. http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf

[3] Ayres, Ian and Curtis, Quinn, "Beyond Diversification: The Pervasive Problem of Excessive Fees and 'Dominated Funds' in 401(k) Plans" (February 21, 2014). Yale Law & Economics Research Paper # 493. Available at SSRN: http://ssrn.com/abstract=2399531 or http://dx.doi.org/10.2139/ssrn.2399531

[4] "Broker Incentives and Mutual Find Market Segmentation," Diane Del Guercio, Jonathan Reuter, and Paula A. Tkac, National Bureau of Economic Research, http://www.nber.org/papers/w16312

[5] "It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plans," Veronika K. Pool, Clemens Sialm, Irina Stefanescu, NBER Working Paper No. 18764 February 2013 http://www.nber.org/papers/w18764

[6] Report on the 2015 fi360 Fiduciary Standard Survey from fi360 and FiduciaryPath, "Seeking Trusted Advice for Individual Investors." http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf

Many survey participants added comments -- some said that extending a fiduciary duty to brokers may "filter out products that may be suitable, but are not in clients' best interests. That's a good thing." We agree.

In addition, academic research shows that in states where there already is a fiduciary requirement for brokers, there has been no change in the number of brokers providing advisory services to investors -- even though they have to act in the best interest of their client.[7]

To recap:

- Nearly 91% say no, it does not cost more to work with a fiduciary advisor than a broker.
- 83% say no, a fiduciary standard would not price investors out of the market for advice.
- 78% say no, fiduciary duty for brokers would not reduce investor access to products or services for investors.

The opposition's myths are just not plausible. Those myths are -- Busted.

Disclosures and Investor and Adviser Behavior: It's Not What You Would Expect

We applaud the DOL for requiring transparency and disclosure of cost and performance projections and comparisons to like investments.

We also are heartened to see that it is not an option to "disclose and waive" investor's best interest requirements, or "disclose and harm" – that the best interests of the retirement investor are the North Star, and not negotiable.

Transparency is Necessary But Disclosures Are "Ineffective" and Often, Worse

While transparency is crucial, disclosures of costs (and other information) to the investor have many unexpected and perverse effects on the investor, and on many well-meaning advisors, and certainly on salespeople, according to current academic research.

Disclosures are necessary, but not sufficient to fulfill fiduciary duty. Transparency is essential. The adviser needs to avoid the conflicts in the first place, and manage unavoidable conflicts in the investor's best interest – not disclose, proceed, and harm.

The effects of disclosures are surprising and quite unsettling. **Regulators may not be aware of the effects even good disclosures have on even well-meaning advisers and investors**, according to Prof. Dalian Cain, Yale School of Management, in "The Dirt on Coming Clean: The Perverse Effects of Disclosing Conflicts of Interest." [8]

According to Dr. Cain's research:

"*Conflicts of interest can lead experts to give biased and corrupt advice. Although disclosure is often proposed as a potential solution to these problems, we show that it can have perverse effects. First, people generally do not discount advice from biased advisors as much as they should, even when advisors'*

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[7] Finke, Michael S. and Langdon, Thomas Patrick, The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice (March 9, 2012). Available at SSRN: http://ssrn.com/abstract=2019090 or http://dx.doi.org/10.2139/ssrn.2019090

[8] Cain, Daylian M., George Loewenstein, and Don A. Moore. "The dirt on coming clean: Perverse effects of disclosing conflicts of interest." *The Journal of Legal Studies* 34.1 (2005): 1-25.

conflicts of interest are disclosed. Second, disclosure can increase the bias in advice because it leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further. As a result, disclosure may fail to solve the problems created by conflicts of interest and may sometimes even make matters worse."

Transparency is Necessary But Disclosures Are "Ineffective" and Often, "Worse"

Some of the most recent work on disclosures and their effects on even well-meaning advisers, and investors receiving advice after being disclosed to, indicates that the effects are extremely perverse, according to Dr. Cain. Dr. Cain's research is compelling and it underscores the fact that disclosure is not enough to mitigate conflicts of interest or fulfill fiduciary duty to investors.

A 2013 research paper, "The Burden of Disclosure: Increased Compliance with Distrusted Advice," by Sunita Sah, George Loewenstein, and Dr. Cain, continues work they have led for years.[9] Their research indicates:

"Professionals are often influenced by conflicts of interest when they have a personal, often material, interest in giving biased advice. Although disclosure (informing advisees about the conflict of interest) is often proposed as a solution to problems caused by such conflicts, prior research has found both positive and negative effects of disclosure. ***We present four experiments that reveal a previously unrecognized perverse effect of disclosure:*** *While disclosure can decrease advisees' trust in the advice,* ***it simultaneously increases pressure to comply with that same advice.*** *We demonstrate that the increased pressure results from advice recipients feeling obliged to help satisfy their advisors' personal interests when those interests have been disclosed.* ***Hence, disclosure can burden those it is ostensibly intended to protect.***

Dr. Cain notes that there are some requirements that may help mitigate these perverse effects:
"The increased pressure to comply is reduced if (1) the disclosure is provided by an external source rather than from the advisor, (2) the disclosure is not common knowledge between the advisor and advisee, (3) a cooling-off period is introduced, or, (4) the advisee can make the decision in private."

One More Thought on Disclosures

Few put it better than writer James Surowiecki, writing in *The New Yorker*: "Transparency is well and good, but accuracy and objectivity are even better. Wall Street doesn't have to keep confessing its sins. It just has to stop committing them."[10]

Annuities Awareness: What Annuities Owners Do and Don't Understand About Their Annuities.

Findings of a recent survey of annuity counselors in a large RIA firm indicate that most investors are **not aware of the total fees they pay** on the annuities, or many other contract provisions. They're unaware that the return percentages quoted include the return of their own principal that they put into the annuity, that those return percentages often include a "come hither" starting rate which changes as soon as six months in, and they're not aware that their principal is being returned to them, that there is no principal left at the end, unlike in a mutual fund or most other investments.

The Annuity counselors work with annuity owners to determine whether it is in their best interest to remain in an annuity or not. This firm has spoken with 5,000 annuity owners regarding 10,000 annuity contracts.

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[9] "The Burden of Disclosure: Increased Compliance with Distrusted Advice," Sah, Sunita and Loewenstein, George and Cain, Daylian M., The Burden of Disclosure: Increased Compliance with Distrusted Advice (December 7, 2011). Sah, S., Loewenstein, G., & Cain, D. (2013). The Burden of Disclosure: Increased Compliance with Distrusted Advice. Journal of Personality and Social Psychology, Vol 104(2), 289-304. doi: 10.1037/a0030527.
SSRN: http://ssrn.com/abstract=1615025 or http://dx.doi.org/10.2139/ssrn.1615025

[10] "The Talking Cure," *The New Yorker*, 12/9/2002, http://www.newyorker.com/magazine/2002/12/09/the-talking-cure

The annuity counselors call the annuity-issuing insurance company, with the annuity owners, to uncover the facts about the annuities contracts. These are the counselors' conclusions from these three-party discussions with thousands of annuity owners.

Variable Annuities
How many annuity owners are unaware of the total fees they are paying annually for their VA?

- 62% of the annuity counselors say **annuities owners are "almost always" unaware of the total fees they are paying for their VA.**
- Another 31% of the annuities counselors say 75**% or more VA owners are unaware of the total fees they pay**.

That means **more than 9 out of 10 counselors, 93%, say more than three-quarters of VA investors are unaware of the total fees they pay -- with nearly a two-thirds majority of VA investors almost always unaware of the total fees they pay.**

How many annuity owners have a VA in their qualified retirement account?

The counselors found that **at least 50% of annuity owners have a VA in their qualified account. (That's a very expensive retirement investment, and it's not appropriate location of that asset -- there is no need for the annuity's tax deferral in an IRA.)**

- Nearly a quarter, 23%, of the counselors said **more than 75% of the VA owners they talked with had a VA in their qualified retirement account**
- Almost half the counselors, 46%, say **more than half, but less than three-quarters of the annuity owners had a VA in their qualified retirement account**.
- The rest of the counselors, 31%, **said 50% of annuity owners had a VA in their qualified account.**

How many annuity owners do not understand that death benefits are taxable (as opposed to life insurance which is not)?

- More than 92% of the counselors said **more than half of annuity owners do not understand that the death benefits are taxable** (unlike regular life insurance)
- 31% said annuities owners are **almost always, unaware that annuity death benefits are taxable**
- 38% of the counselors found **75% or more annuity owners were unaware that the death benefit is taxable**

There is much more to come from this research and we will be reporting on that soon.

The Sales Relationship versus The Relationship of Trust

No retirement investor would knowingly harm herself or himself. When harm is caused to a retirement investor it is typically because they have been scared and/or deceived into buying a high commission, high fee annuity or other high cost investment product. They are harmed because a salesperson, measured by how much commission and fee revenue they "produce," has used deceptive, misleading or fraudulent sales tactics that are coldly calculated to scare the investor into thinking they will run out of money in retirement.

This sales deception, masquerading as "advice," begins with advertising that brands banks, brokerage firms, and insurance companies as "trusted advisers," invited to family weddings and retirement dinners. "We are," they say, "on your side." "We put members first." "We are advocates

for our customers, put them at the center of everything we do." But when harm comes to light, they disavow any fiduciary duty to the retirement investor.

Deceptive, Misleading, Fraudulent Sales Tactics, Advertising, Titles

The titles issue is especially deceptive: a recent survey of investment advisers, brokers, dual registrants and insurance reps, asked, "Do you believe the titles "advisor," "consultant," and "planner" imply that a fiduciary relationship exists?" 72% of survey participants say these titles imply a fiduciary relationship with clients.[11]

Public Policy and Retirement in America
What Happens When Retirement Investors Are $2 Trillion Poorer at Retirement?

We note that the DOL has been very conservative in its estimates of the current harm to retirement investors. One estimated shortfall to retirement investors, of $1 Trillion dollars, (just in one segment, mutual funds, in one retirement vehicle, IRAs) is unworkable and unacceptable. Especially when this shortfall is caused by a deliberate and systemic looting of retirement investors' nest eggs by less progressive Wall Street banks, brokers, insurance companies, and mutual fund companies who pretend to be trusted advisers, but are arranging their businesses to extract the highest dollar amounts from investors via kickbacks, hidden commissions and fees and deceptive sales tactics in the guise of "advice." Of course, they don't think of it as looting America's retirement savers – they think of it as "business as usual."

DOL notes that just 1% in extra fees can leave a retirement investor with 27% less in their nest egg. Well-respected economic and investment leaders note that 200 basis points, (2%) of excess fees per year, is typical and can take 50% out of a retirement investor's nest egg. (David Swensen of Yale, and Burton Malkiel of Princeton). When you add in other types of investment alternatives in IRAs, such as annuities, where the costs to investors are much higher, 4% to 10% annually, and another 7% to 10%, in penalties or even 20% in surrender fees, the actual retirement investor shortfall is likely to be much higher than the DOL's conservative $1 Trillion -- closer to $2 Trillion over the next 20 to 40 years.

Less progressive banks, broker-dealers, insurance companies, mutual fund companies are sharing, in the short term, retirement investors' savings that should remain in their accounts, compounding and growing. It should be growing in investors' nest eggs. And then, retirees can spend it in the American economy over the next two to four decades – $1 Trillion to $2 Trillion dollars.

One has to ask: **If private companies are allowed to continue extracting such a toll in unreasonably high commissions and fees from retirement investors, and retirement investors would be missing $1 to $2 Trillion from their retirement nest eggs, how will these retirement investors get by in retirement? Who will make up this shortfall?** Taxpayers? This could mean that the federal government would need to engineer a bailout plan bigger than what we have seen over the past eight years -- all because corporations have taken out so much -- for themselves -- from retirement investor's nest eggs. Corporate greed resulting in a federal bailout paid for by American taxpayers.

Let's correct this now, before retirement investors lose any more of their nest eggs to Wall Street and Insurance companies.

This is the choice we face here, and why it is so **vital that all who have the privilege of advising retirement investors must do so in the Investor's Best Interest.**

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[11] Report on the 2015 fi360 Fiduciary Standard Survey from fi360 and FiduciaryPath, "Seeking Trusted Advice for Individual Investors." http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf

So many Americans have little idea why this rulemaking is so important – yet they do know something is not right. They cannot always articulate it. DOL articulates it in this rulemaking. And this is why this DOL rulemaking must proceed, and quickly.

So that all Americans saving and investing for a dignified and financially secure retirement can attain that worthwhile goal.

Thank you.

Respectfully submitted,

Kathleen M. McBride, AIFA®

Chair, The Committee for the Fiduciary Standard | www.TheFiduciaryStandard.org
Accredited Investment Fiduciary Analyst®
CEFEX Analyst | Centre for Fiduciary Excellence | www.CEFEX.org

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Consumer Federation of America

March 2, 2015

Re: Oppose H.R. 1090

Dear Representative:

Last week, Representative Ann Wagner (R-MO) introduced H.R. 1090, the cynically misnamed "Retail Investor Protection Act." This bill would erect new barriers to slow or stop efforts by the Department of Labor (DOL) and the Securities and Exchange Commission (SEC) to adopt new rules to require all financial advisers to act in the best interests of their clients when providing investment advice. By impeding their efforts, this bill would in no way protect retail investors; instead, it would protect those financial professionals who take advantage of loopholes in the law to profit at their clients' expense.

Under our current regulatory regime, certain financial professionals are allowed to hold themselves out as trusted advisers but not comply with the fiduciary standard that traditionally applies to those in a position of trust. Both the DOL and SEC are working to update and strengthen the ethical standards that apply when financial professionals provide investment advice to their clients. While some have suggested that these rules are likely to create conflicts, each agency has an important and unique role when it comes to protecting the quality of advice that financial professionals provide to investors.

Under the Employee Retirement Income Security Act (ERISA), the DOL has exclusive authority over retirement accounts, including traditional pension plans and defined contribution plans such as 401(k)s, and shared authority over Individual Retirement Accounts (IRAs). Under the securities laws, the SEC has exclusive authority over private securities accounts and shared authority over IRAs. The SEC's authority is limited to recommendations regarding securities, while the DOL's is not. Because neither agency currently requires all those who provide advice to act in their customers' best interests, both agencies must act to provide comprehensive protections governing the provision of investment advice.

The DOL is significantly farther along in its rulemaking process than the SEC. Last week, the DOL sent its proposal to the Office of Management and Budget for interagency review and it is expected that the proposal will be issued for public comment in the next few months. The SEC, on the other hand, has been studying the issue for years, and no one at the agency can provide a definitive answer as to when the SEC is going to move forward with its rulemaking process or even any assurance that it will.

This bill is a clear attempt to thwart DOL action by making the DOL wait indefinitely to proceed with its rulemaking to strengthen protections under ERISA until after the SEC finalizes a rule under securities laws. And, to further delay SEC action, the bill imposes on the SEC new

requirements to engage in further economic analysis, beyond the extensive analysis it has already conducted, and make formal findings before promulgating a rule. This approach puts both agencies in a vice, effectively crippling both their abilities to fulfill their unique and critical regulatory roles. Moreover, with no justification, it also subjugates an executive agency's jurisdictional authority to an independent agency's.

Investors face a multitude of complex decisions when saving for retirement and other important goals. They often turn to professionals for advice to help them navigate these difficult decisions. To ensure that the financial professionals are serving their clients' best interests, the rules that apply to financial advisers must be updated, and the DOL and SEC should be allowed to proceed with their rulemakings without manufactured roadblocks. Therefore, we urge you to oppose this ill-conceived and dangerous legislation.

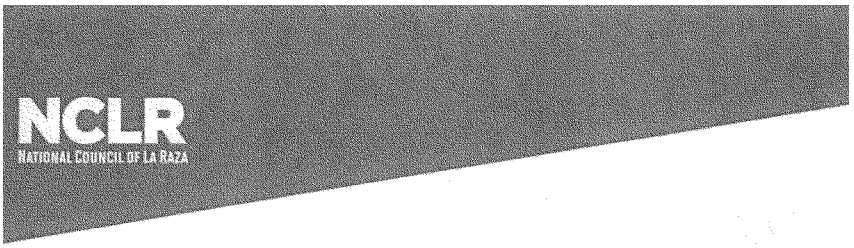
Sincerely,

Micah Hauptman

Micah Hauptman
Financial Services Counsel

Barbara Roper

Barbara Roper
Director of Investor Protection



TESTIMONY OF THE NATIONAL COUNCIL OF LA RAZA

Hearing on
"Preserving Retirement Security and Investment Choices for All Americans"

Submitted to
U.S. House of Representatives
Financial Services Committee
Subcommittees on Capital Markets and Government Sponsored Enterprises
and Oversight and Investigations

Submitted by
Eric Rodriquez
Vice President
Office of Research, Advocacy, and Legislation

September 10, 2015

Raul Yzaguirre Building
1126 16th Street, NW, Suite 600
Washington, DC 20036-4845

www.nclr.org

The National Council of La Raza (NCLR) is the largest national Hispanic civil rights and advocacy organization in the United States. We have a strong history of advancing consumer protections and retirement security through policy and practice. We have supported public policies to protect Latino and low-income consumers from harmful financial products, including mortgages with usury terms and short-term loans with exorbitant interest rates. One in four NCLR Affiliates—community-based organizations that serve millions of Hispanic Americans throughout the country—provides financial coaching and mortgage counseling. NCLR is also a leading voice for strengthening retirement savings among Latinos. Latinos are projected to account for a majority of the growth in the American workforce through 2050; therefore, avoiding a national retirement crisis hinges on Latinos' ability to save for retirement.

For these reasons, NCLR submits testimony signaling our **opposition to H.R. 1090**, the "Retail Investor Protection Act." Contrary to its misleading title, this piece of legislation would effectively end the Department of Labor's (DOL) efforts to protect retirement savers from bad investment advice. NCLR supports DOL's proposed conflict of interest rule on retirement investment advice because it would achieve that goal by closing loopholes in the definition of fiduciary investment advice that allow firms to evade their fiduciary obligations. At the same time, the proposal eases restrictions on the types of compensation financial firms can receive as long as they abide by appropriate regulatory restrictions, including requirements to act in the best interests of their client.

The proposed conflict of interest rule would strengthen the financial security of Hispanics, who are already disadvantaged in the retirement space. Structural factors inhibit Latinos from saving enough for retirement, making it all the more imperative that the advice they receive helps them improve savings and bolster their account balances. Further, as Latinos tend to have lower balances in their retirement account, higher fees represent a higher proportion of their retirement savings absorbed by advisers and financial institutions. Quality standards to protect Latinos and other low-income consumers from harmful advice are essential to promote retirement security and financial stability.

Please find attached NCLR's comments submitted to the Department of Labor in support of the conflict of interest rule. We urge you to oppose H.R. 1090 and any other efforts to thwart this rule-making, including the adoption of industry-advocated alternatives that fail to protect consumers or efforts to defund the rule-making process. Thank you for the opportunity to submit testimony for the record. Should you have any questions, please contact Amelia Collins at acollins@nclr.org.

Sincerely,

Eric Rodriquez
Vice President,
Office of Research, Advocacy, and Legislation

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NATIONAL COUNCIL OF LA RAZA

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July 20, 2015

SUBMITTED BY ELECTRONIC DOCKET

U.S. Department of Labor
Employee Benefits Security Administration
Office of Regulations and Interpretations
200 Constitution Avenue, NW
Room N-5655
Washington, DC 20210

Re: Comments on RIN 1210-AB32: Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice

To Whom It May Concern:

The National Council of La Raza (NCLR)—the largest national Hispanic* civil rights and advocacy organization in the United States—submits to the Employee Benefits Security Administration (EBSA) the following comments **in support** of the proposed regulatory changes to the definition of the term "fiduciary" for employee benefit plans under the Employee Retirement Income Security Act of 1974 (ERISA).

NCLR has a strong history of advancing consumer protections and retirement security through policy and practice. We have supported public policies to protect Latino and low-income consumers from harmful financial products, including mortgages with usury terms and short-term loans with exorbitant interest rates. One in four NCLR Affiliates—community-based organizations that serve millions of Hispanic Americans throughout the country—provides financial coaching and mortgage counseling. NCLR is also a leading voice for strengthening retirement savings among Latinos. Latinos are projected to account for a majority of the growth in the American workforce between 2010 and 2050; therefore, avoiding a national retirement crisis hinges on Latinos' ability to save for retirement.[1] Protecting consumers who are making retirement investment decisions is vital to ensuring that those who have spent their lifetimes working to support their families have adequate savings.

The proposed rule would strengthen the financial security of Hispanics, who are already disadvantaged in the retirement space. Structural factors inhibit Latinos from saving enough for retirement, making it all the more imperative that the advice they receive helps them improve savings and bolster account balances. Further, as Latinos tend to have lower balances in their retirement accounts, higher fees represent a higher proportion of their retirement savings absorbed by advisers and financial institutions. This makes Latinos even more vulnerable to

* The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

financial instability. Instituting quality standards for advice provided for a fee is especially important to Latino and other low-income consumers to ensure that the advice they receive is truly in their best interest.

Retirement Savings Are Already in Jeopardy

Too many Americans have difficulty saving for retirement. The retirement savings deficit is exacerbated for communities of color, with 62% of Black and 69% of Hispanic households lacking any assets in a retirement account.[2] For those who do save, their account balances are disproportionately low: three in four Black households and four in five Latino households aged 25–64 have less than $10,000 in retirement savings, compared to one in two White households.[3]

The difficulty in saving for retirement is the result of a variety of factors, including low access to employer-sponsored retirement plans and lower rates of participation in those plans. Workers of color have less access to retirement savings vehicles compared to Whites: 38% of Latino employees, 54% of Black employees, and 54% of Asian employees aged 25–64 work for an employer that sponsors a retirement plan, compared to 62% of White employees.[4] Of those workers who have access to an employer-sponsored plan, not all participate, and the 29.7% Latino participation rate falls well below the 53.8% rate for Whites.[5]

Further, low wages make investing for retirement especially challenging as costs for housing, health care, and education rise—even as wages stagnate. According to a 2014 analysis, among lower-income individuals (below 300% of the federal poverty level), 22% reported that they participated in a pension plan at their current job between 1992 and 2010, compared to 59% of higher-income individuals (over 300% of the federal poverty level).[6] In 2011, 43.3% of employed Latinos earned poverty-level wages, compared to 23.4% of the White labor force.[7]

Consumers Rely on Financial Advice to Navigate Complex Options

Consumers capable of saving for retirement face an environment of complex investment options. Many Americans are unable to chart the course alone and rely on professional advisers to provide guidance. Overall, a recent survey found that 58% of households with traditional IRAs relied primarily on a professional financial adviser when crafting a retirement strategy.[8] Hispanics also rely on professionals for financial advice, with one survey finding that 6% seek advice from brokers and 17% seek advice from financial planners.[9] While this is relatively small compared to the 26.8% of non-Hispanic Americans who use financial planners, 17% is still a significant share, and any contact with an adviser is important to an individual's financial security.

One of the most common decisions in which advisers play a role occurs when an investor changes jobs. Investors must choose whether to cash out their existing defined-contribution retirement account or roll it over into an IRA. Given that Latino workers are more mobile relative to their peers, they face this financial decision more frequently. Rollovers are the primary source of funding for IRAs,[10] and one survey found that over a five-year period 40.2% of traditional IRA investors made a rollover transaction.[11] However, Latino workers tend to cash out their 401(k) balances at higher rates than other Americans. A study revealed that 57% of Hispanics who left an employer in 2010 cashed out their retirement plan compared to 39% of White workers.[12] The decision to cash out a savings plan is often not in the best interest of the

consumer. Ensuring sound investment advice at this point in financial decision-making is critical to prevent the loss of savings.[†]

Protecting Consumers from Conflicted Advice Is Essential for Financial Stability
ERISA was enacted in 1974, before the creation of 401(k) plans and investment rollovers, to protect workers and their retirement investments. As the retirement savings market has evolved, the regulations protecting savers must evolve as well. In the current environment, 80% of financial advisers do not meet the criteria threshold to be considered a "fiduciary,"[13] allowing them to receive compensation through fees and commission based on the products their client selects after receiving advice. This breeds conflicts of interest where the best advice for the investor's retirement savings might not maximize profit for the adviser. The proposed regulations would help prevent the negative consequences of conflicted advice by ensuring that those acting as a fiduciary make recommendations that are in the best interest of the investor.

Mitigating these conflicts of interest would result in greater financial security for consumers and the economy at large. IRAs and 401(k) plans together hold the greatest portion of retirement assets, estimated at almost $12 trillion,[14] demonstrating the potential economic impact of conflicted advice on investors. A report by the White House Council of Economic Advisers found that conflicted advice regarding IRA accounts alone results in billions in lost savings. Specifically, the report found that conflicted advice leads to lower investment returns of about one percentage point per year, translating to $17 billion in lost returns annually.[15] In 2014, more than 34 million households owned IRAs,[16] with over 21% of those households having an annual income under $50,000.[17] Lower returns as a result of conflicted advice translate to less money upon retirement for a population already struggling to save enough.

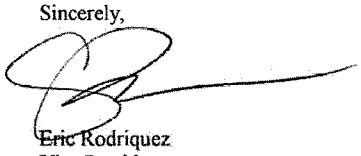
Contrary to the assertion by some stakeholders in the financial services industry, the revised definition of fiduciary will not unduly restrict financial advisers from serving low- to middle-income savers. Numerous companies already serve this population as fiduciaries with a low-fee model, including Wealthfront, Vanguard, and Seabridge Wealth Management.[18,19,20] These firms offer low-fee services and have emerged as leaders in the industry: Vanguard is the second-largest exchange-traded fund (ETF) provider, with over $430 billion in ETF assets, composing roughly 22% of market share.[21] NCLR considers it a missed opportunity that mainstream plan sponsors tend not to target lower-income consumers, and we support the efforts of companies that are venturing into this space with innovative products. When businesses are willing, they can successfully adapt their products and policies to serve low-balance accounts and savers with lower income streams.

[†] Age is likely a major factor in Latinos' higher rate of cashing out. Analysis by Fidelity found that younger workers are more likely to cash out their 401(k) retirement plans entirely when switching employers, with 43% of those aged 20–29 doing so. Fidelity Viewpoints, "Beware of Cashing Out," March 15, 2015, www.fidelity.com/viewpoints/retirement/cashing-out (accessed June 2015). As the Hispanic population's median age is 10 years less than that of the general U.S. population (27 vs. 37), ill-advised decisions to withdraw retirement savings could have a greater impact on young Latino workers. Seth Motel and Eileen Patten, *The 10 Largest Hispanic Origin Groups: Characteristics, Rankings, Top Countries* (Washington, DC: Pew Research Center), www.pewhispanic.org/2012/06/27/ii-demographics-3 (accessed June 2015).

Proposed Rule Is a Positive Step Toward Reducing Barriers to Saving
A holistic approach to achieving financial security must include adequate savings for retirement, but too many households are not saving enough. Strong protections against unscrupulous investment advice are necessary to protect consumers and their assets from the adverse consequences of conflicts of interest. Even though Latinos use financial advisers and planners at relatively low rates, they receive high-stakes advice because they already face structural barriers to saving and investing. The proposed rule by the Department of Labor to redefine which retirement investment advisers must act in the best interest of their clients would provide consumers with a mechanism to hold their advisers to a high standard, clarifying the fiduciary relationship and transparently outlining cost and compensation structures. These protections and others in the rule are essential to ensuring that retirement advice is in the best interest of those saving for retirement.

Thank you for this opportunity to comment on the proposed revisions to regulations regarding retirement investment advice. Should you have any questions on these comments, please contact Amelia Collins at acollins@nclr.org or (202) 776-1578.

Sincerely,



Eric Rodriquez
Vice President,
Office of Research, Advocacy, and Legislation

Endnotes

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[10] John Turner, *Retirement Savings Flows and Financial Advice: Should You Roll Over Your 401(k) Plan?* (Washington, DC: Pension Policy Center), http://pensionpolicycenter.com/?page_id=310 (accessed May 2015).
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[12] Ariel Education Initiative and Aon Hewitt, *401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups* (Chicago, IL: Ariel/Aon Hewitt, 2012), 14, www.arielinvestments.com/images/stories/PDF/ariel-aonhewitt-2012.pdf (accessed June 2015).
[13] Secretary William Galvin for the Commonwealth of Massachusetts, *Statement of Secretary of the Commonwealth William F. Galvin, Commonwealth of Massachusetts, Middle Class Prosperity Project Forum,* 114th Cong., 1st sess., March 24, 2015.

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[16] Michael Brien and Constantijn Panis, *Financial Asset*, 31.
[17] Ibid., 32.
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[19] Secretary Thomas Perez for the Department of Labor, *Statement of Thomas E. Perez, Secretary of Labor, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, U.S. House of Representatives*, 114th Cong., 1st sess., 2015, www.dol.gov/ebsa/newsroom/ty061715.html (accessed July 2015).
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The seven organizations that launched the SaveOurRetirement.org campaign – AARP, AFL-CIO, AFSCME, Americans for Financial Reform, Better Markets, Consumer Federation of America and Pension Rights Center – are joined by a diverse collection of financial entities, public interest groups, civil rights leaders, labor unions, consumer groups, professional organizations and others in support of the Department of Labor (DOL)'s efforts to update and strengthen the outdated rules adopted 40 years ago that apply when individuals receive professional advice about their retirement investments.

Organizations that support DOL rulemaking to protect retirement savings include:

9 to 5

AARP

AFL-CIO

AFSCME

Alliance for Retired Americans

Alliance for a Just Society

American Association for Justice

American Association of University Women

American Federation of Government Employees

American Federation of School Administrators

American Federation of State, County and Municipal Employees

American Federation of Teachers

Americans for Financial Reform

American Society on Aging

Better Investing

Better Markets

B'nai B'rith International

Center for Community Change

Center for Economic Justice

Center for Elder Care and Advanced Illness, Altarum Institute

Center for Global Policy Solutions

Center for Responsible Lending

Certified Financial Planner Board of Standards

Coalition of Mutual Fund Investors
Colorado Public Employees' Retirement Association
Committee for the Fiduciary Standard
Consumer Action
Consumer Federation of America
Consumers Union
Demos
Department for Professional Employees, AFL-CIO
Economic Policy Institute
Financial Planning Association
Fund Democracy Inc.
Garrett Planning Network, Inc.
International Alliance of Theatrical Stage Employees, Moving Picture Technicians, Artists and Allied Crafts
International Association of Machinists and Aerospace Workers
International Brotherhood of Electrical Workers Union
International Brotherhood of Teamsters
International Federation of Professional and Technical Engineers
International Longshoremen's Association
International Union of Bricklayers & Allied Craftworkers
International Union of Police Associations
International Union, United Automobile, Aerospace & Agricultural Implement Workers of America
Justice in Aging
Iota Phi Lambda Sorority, Inc.
Latinos for a Secure Retirement
Leadership Conference on Civil & Human Rights
Leading Age
Lynn Turner, former SEC Chief Accountant
Main Street Alliance
Metal Trades Department, AFL-CIO
NAACP
National Academy of Elder Law Attorneys (NAELA)
National Active and Retired Federal Employees Association

National Association of Letter Carriers
National Association of Personal Financial Advisors
National Coalition for Asian Pacific American Community Development
National Committee to Preserve Social Security and Medicare
National Consumers League
National Council of La Raza
National Employment Law Project
National Employment Lawyers Association
National LGBTQ Task Force Action Fund
National Organization for Women
National Partnership for Women & Families
National Senior Citizens Law Center
National Women's Law Center
NETWORK, A National Catholic Social Justice Lobby
New York State Comptroller Thomas DiNapoli
OWL-The Voice of Women 40+
Pace Investor Rights Clinic at Pace Law School
Pension Rights Center
Personal Capital
Public Citizen
Public Investors Arbitration Bar Association
Rebalance IRA
Secretary of the Commonwealth of Massachusetts William Galvin
Service Employees International Union
Services and Advocacy for GLBT Elders (SAGE)
Sheet Metal Workers' International Association
Social Security Works
SomeOfUs
United Food and Commercial Workers Union
U.S. PIRG
UNITEHERE!
United Steel Workers
University of Miami Investor Rights Clinic
Wider Opportunities for Women

Woodstock Institute

State and Local Organizations:

California School Employees Association
Chicago Consumer Coalition
Consumer Federation of the Southeast
Massachusetts Consumers' Coalition
Oregon Consumer League

September 2015

The House Financial Services Committee on Thursday will begin its consideration of legislation intended to derail rulemaking by the Department of Labor (DOL) to update and strengthen protections for workers and retirees saving and investing for a secure and independent retirement. We urge you to reject any such proposal that weakens or delays these crucial protections, whether it is based on H.R. 1090 or a phony Wall Street "alternative" to DOL rules. Instead, you should stand with your hard-working constituents saving for retirement who deserve financial advice that is in their best interest, no matter who provides it.

Please consider these key points in support of DOL fiduciary rulemaking:

Retirement investment rules are outdated and lack essential protections. The retirement market today works well for the broker-dealers, insurance companies, and mutual fund complexes that reap billions of dollars in profits providing services to tax-subsidized retirement accounts. But it works much less well for working families and retirees who struggle with complex decisions about how best to save and invest for and in retirement. Rules to protect ordinary savers have not been updated for 40 years. Under these outdated rules, advisers may recommend investments that boost their compensation but saddle clients with high fees and low returns. Protections for working families and retirees need to be strengthened by requiring the financial professionals they turn to for retirement investment advice to act in their best interests.

Additional resources:
Organizations supporting DOL fiduciary rulemaking
The cost to retirement investors of conflicted advice
Fact sheet on the DOL rule: The problem, solution, and misleading attacks
Consumer Federation of America: DOL Fiduciary Questions and Answers
Better Markets: DOL Fiduciary Rulemaking: Myths and Facts

The DOL rule is balanced. The Department of Labor has produced a balanced rule that provides long overdue new protections for retirement savers while providing flexibility for financial professionals to continue to operate under a variety of business models.

Additional resources:
CFA: DOL Delivers on its Promise: Conflict of Interest Rule Proposal Provides Needed Protections for Retirement Savers, Flexibility for Financial Firms
AARP, AFR, Better Markets, CFA: Overview of DOL Conflict of Interest Rule Proposal
SaveOurRetirement: Setting the Record Straight on Industry's "Unworkable" Claim

Industry alternatives are "unworkable" for retirement savers. Congress should reject any proposals such as the "alternative" approaches advanced by various industry players that purport to impose a best interest standard but that fail to protect investors in any meaningful way. As constructed, DOL's proposed rule recognizes that a "best interest" standard sets a higher bar than a "suitability standard" and that, to be effective, any such standard must be backed by real mitigation of financial conflicts of interest. As such, the proposed rule is absolutely consistent with the reasonable expectations of retirement savers when they turn to financial professionals for advice. In contrast, the industry's alternative "best interest" standard is such a standard in name only.

Additional resources:

CFA, AFR, Better Markets: Fidelity's 'New Best Interest Paradigm' Does Not Serve the Best Interests of America's Working Families and Retirees
CFA: Statement on SIFMA's Proposed Best Interests of Customer Standard for Broker-Dealers

No need to wait for the SEC to act. Congress should reject HR 1090, or any other measure that attempts to obstruct DOL from protecting retirement investment savers by passing the buck to the Securities and Exchange Commission (SEC). If the SEC ever gets around to adopting a new rule for investment advice – action that is far from guaranteed given that it has been considering this issue for over a decade without even proposing a rule -- it would be limited to recommendations regarding securities. An SEC rulemaking would not apply to recommendations of insurance products, which form an important part of the retirement market, or other non-securities investments that are sold to investors through retirement accounts. These restrictions on SEC jurisdiction mean that an SEC rule could never protect a significant share of employment-based retirement savings. Moreover, the DOL has gone out of its way to incorporate securities law principles in its rule: the DOL definition of investment advice is virtually identical to the securities law definition; the best interest standard closely parallels Section 913 of Dodd-Frank, where Congress identified "best interests, without regard to the financial or other interests of the adviser" as the standard that should apply if the SEC were to adopt rules under the securities laws; and DOL deals with issues related to ongoing duty of care and sales from a limited menu of proprietary products in ways that are consistent with the principles in Dodd-Frank.
Additional resources:
Requiring the DOL to Wait for the SEC Is a Groundless Tactic to Derail the Rule
June 3, 2015 letter from Better Markets to FINRA Chairman and CEO
Fund Democracy, Consumer Federation of America, AARP, Americans for Financial Reform, and Public Citizen's Congress Watch: October 18, 2013 letter to OMB on SEC vs. DOL jurisdiction

Small savers will NOT lose access to advice and products. Do not be taken in by the industry argument that many financial professionals will simply stop serving this market if the rule is adopted and that small investors will be harmed if they lose access to advice or are forced into more expensive fee accounts. The truth is that there is no compelling evidence that brokerage accounts are consistently more affordable than fee-based accounts when the total cost of investing is taken into account. And, there are many advisers who already provide investment advice to retirement savers under the best interest standard, and they will be happy to take on any clients abandoned by advisers who refuse to put their clients' financial interests ahead of their own.
Additional resources:
Ray Ferrara, CFP®, chairman and CEO of ProVise Management Group LLC, blog, "DOL's fiduciary standard: Good for clients; workable for advisers," The Hill
Financial Planning Coalition testimony before the Department of Labor
Better Markets: Don't fall for SIFMA's Spin Campaign

Retirement investors need sound advice, not a sales pitch. The Department of Labor's proposed rule will help ensure that, when workers and retirees turn to financial professionals for investment advice, they get objective advice that is in their best interest, rather than a sales pitch for an expensive product dressed up as advice. The proposed rule won't solve every problem with our retirement system, but it is very much worth fighting for. We urge you to reject any efforts –whether through stand-alone legislation or a policy rider on a spending bill –that would derail this initiative. It is critical to helping Americans save and invest for a secure retirement.
Additional resources:
Read comment letters to the DOL from Americans for Financial Reform, AFSCME, Better Markets, Center for American Progress, Consumer Federation of America, Committee for a Fiduciary Standard, Consumer Action, Consumers Union, Financial Engines, Financial Planning Coalition, Fund Democracy, The Leadership Conference on Civil and Human Rights, National Association of Social Workers,

National Council of La Raza, National Women's Law Center, Organizations Concerned with the Well-Being of America's Older Population, Pension Rights Center, Personal Capital and Public Investors Arbitration Bar Association

Consumer Federation of America

"Preserving Retirement Security and Investment Choices for All Americans"

Joint Hearing of the
Capital Markets and Government Sponsored Enterprises Subcommittee and the Oversight and Investigations Subcommittee
Financial Services Committee
U.S. House of Representatives
September 10, 2015

Written Testimony of Barbara Roper, Director of Investor Protection
Consumer Federation of America[1]

I appreciate the opportunity to submit this written statement for the record of this week's hearing on the Department of Labor (DOL) conflict of interest rule proposal and related exemptions, the current state of regulation that applies to broker-dealers and investment advisers when providing advice and services to retail investors, and H.R. 1090, the Retail Investor Protection Act.

CFA is a strong supporter of the DOL rule proposal, which once finalized will help to ensure that all financial professionals who provide retirement investment advice are subject to the fiduciary standard appropriate to that role. Contrary to industry claims, the rule takes a balanced and flexible approach that will allow well-meaning financial professionals operating under a variety of business models to comply. We have also long advocated action by the Securities and Exchange Commission (SEC) to hold broker-dealers to a fiduciary standard when they provide personalized investment advice to retail investors. Because the two agencies have different areas of jurisdiction, investors need both agencies to act to receive comprehensive protections when they turn to financial professionals for investment advice.

Although we support rulemaking by both DOL and SEC, we strongly oppose H.R. 1090, and similar industry proposed alternatives, that would inappropriately link these two efforts. The sad fact is that, despite years of entreaties from investor advocates, the SEC has failed to make serious headway to address this important issue. Although it has conducted several studies documenting the need for rulemaking, it has failed to propose, let alone finalize, an appropriate

[1] The Consumer Federation of America is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

rule. Nor has it taken effective action to rein in toxic conflicts of interest that pervade the broker-dealer business model, to limit deceptive broker-dealer marketing of their services as if they constituted objective advice, or even to require effective disclosure of costs and conflicts associated with that advice.

In light of this regulatory failure on the part of the SEC, forcing DOL to wait for the SEC to catch up before finalizing a fiduciary rule would only result in further delays in protections investors need and deserve now. Meanwhile, DOL has proposed a rule that is consistent with the principles Congress laid down in Section 913 of the Dodd-Frank Act, and even borrows its best interest standard directly from that statute. Indeed, far from suggesting that DOL should wait and take its lead from the SEC, Congress should be urging the SEC to follow the DOL's lead in proposing a strong and effective rule to ensure that all financial professionals are required to put their customers' interests first and to limit the practices that reward and incent advice that is not in the customer's best interests.

CFA has written extensively on these topics. Rather than repeat those arguments here, I am incorporating the relevant documents as appendices to this statement.

In July, CFA submitted an extensive comment letter in support of the DOL rule. In it, we explain why the rule is needed to close gaping loopholes in protections for retirement savers, how investors are being harmed under the existing woefully inadequate rules, and why we believe the proposed rule is a reasonable and balanced approach to address those problems. The letter also explains how the Department has incorporated securities law principles in its proposed rules, creating an opportunity for harmonization of the standards if the SEC were eventually to follow its lead and propose a strong, pro-investor rule. I have attached the CFA comment letter as Appendix A.

Last month, I testified at the Department of Labor's four-day hearing on the proposed rule. My oral statement, which is attached as Appendix B, addresses common industry arguments in opposition to the rule. It reveals the fallacies behind industry claims to support a best interest standard, explains why the Department should not defer to securities regulators, and exposes the industry's claim that it will stop serving the multi-trillion-dollar retirement market as the empty threat it is.

Since the DOL rule was reproposed, we have spent some time analyzing the various industry proposals put forward as "alternatives" to the DOL proposal, and will continue to do so in coming weeks. While some concrete suggestions have been put forward to improve the rule, and are expected to get a favorable response from the Department, the bulk of industry's comments are focused on preserving the loopholes that enable them to escape their fiduciary obligations when providing services that retirement savers perceive and rely on as objective advice and watering down the best interest standard that would apply under the best interest contract exemption. I have attached our brief analyses of the Fidelity and SIFMA alternatives as Appendix C and D respectively. We will be expanding on this analysis in a follow-up comment letter to the Department in the coming weeks.

Additional materials refuting common industry arguments against the rule are included in Appendix E. These include a Q&A fact sheet on the rule, a refutation of the argument that the rule will lead to a flood of litigation, and a rebuttal of the argument that the rule will hurt small advisers.

Finally, we have previously written in opposition to H.R. 1090, the cynically misnamed Retail Investor Protection Act, which would erect new barriers to slow or stop rulemaking efforts by both the DOL and the SEC. A copy of our letter of opposition is attached as Appendix F.

Retirement savers who are struggling to fund an independent and secure retirement need financial advice they can trust. Today, neither our securities regulations nor the rules under ERISA provide that assurance. Instead, both sets of regulations expose retirement savers to self-serving recommendations from conflicted advisers who are free to recommend products based on their own financial interests rather than those of their customers. The DOL proposal – which combines a best interest standard with meaningful restrictions on the practices that undermine that standard -- offers significant progress toward addressing this problem. We can only hope that the SEC will eventually follow the Department's lead and craft a similarly strong and effective rule for non-retirement accounts. But in a nation that faces a retirement crisis, and with DOL ready to act, we cannot afford to wait. We therefore urge you to support its efforts to finalize a rule based on the eminently sound regulatory approach in has proposed.

Thank you for your attention to our concerns.

Appendix A: CFA Comment Letter on Department of Labor Conflict of Interest Rule

Consumer Federation of America

July 21, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Conflict of Interest Rule, RIN 1210-AB32
Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25
Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, ZRIN 1210-ZA25

Ladies and Gentlemen:

We are writing on behalf of the Consumer Federation of America (CFA)[2] to express our strong support for the package of rule changes and exemptions proposed by the Department of Labor (DOL) to strengthen protections for retirement savers. The rule proposal addresses a very real problem involving self-interested retirement investment advice, curbs industry practices that eat into Americans' retirement nest eggs, and does so in a way that should allow well-meaning financial professionals operating under a variety of business models to comply. While a few adjustments to the proposal can and should be made to clarify certain requirements and streamline or enhance others, this is a strong regulatory package that will help to ensure that all Americans who turn to financial professionals for advice about their retirement savings will receive advice that puts their interests first and promotes their ability to afford a secure and independent retirement. We urge you to move forward without further delay to finalize this vitally important rule.

I. Background

A. Loopholes in the Current Rule Expose Retirement Savers to Self-Interested Recommendations from Conflicted Advisers.

The Employee Retirement Income Security Act (ERISA) defines as a fiduciary adviser anyone who "renders investment advice for a fee or other compensation, direct or indirect, with

[2] The Consumer Federation of America is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

respect to any moneys or other property of such plan, or has any authority or responsibility to do so."[3] When rules were adopted implementing ERISA, however, the DOL included a five-part test that must be met before an individual is deemed to be giving fiduciary investment advice. That five-part test had the effect of significantly narrowing the definition. Of particular concern are provisions requiring that the advice be given on a regular basis and subject to a mutual agreement between the adviser and the advice recipient that the advice serves as the primary basis for the investment decision.

As a result of this regulatory narrowing of the definition, many financial professionals who "render investment advice" to retirement plans and retirement savers "for a fee or other compensation" are not covered by ERISA's fiduciary duty. In particular, broker-dealers, insurance agents, and other sales-based advisers have used these loopholes in order to preserve their ability to provide services to retirement savers without having to comply with their fiduciary obligation under ERISA to act "solely in the interests" of those retirement savers and "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." The result is that, precisely where the conflicts of interest are most intense and the risks to the retirement saver are greatest, the protections intended by Congress when it enacted ERISA do not apply.

1. *Changes in the retirement landscape since the rules were adopted amplify the risks to retirement savers.*

Such a restrictive application of the fiduciary standard may have seemed appropriate 40 years ago, when the rules under ERISA were enacted, but it is indefensible today. Three changes in particular have rendered it obsolete. The first is the growing reliance on defined contribution retirement accounts in place of traditional defined benefit pension plans. The second is the rise of rollovers out of retirement plans as a significant feature of the retirement saving landscape. The third is the growing complexity of financial products and financial markets. The combined effect of these changes is to render individuals increasingly responsible for making their own retirement investment decisions at a time when those decisions are increasingly difficult to make.

When ERISA was enacted, traditional defined benefit pension plans were far more common than they are today. Thus, the primary recipient of advice under ERISA at that time was likely to be a professional manager of a pension fund. But the retirement market has changed dramatically since then. The number of active participants in private-sector defined benefit plans declined from 27.2 million in 1975 to 15.7 million in 2012. Meanwhile, the number of active participants in private-sector defined contribution plans increased from 11.2 million in 1975 to 75.4 million in 2012.[4] As a result, recipients of advice under ERISA today are far more likely to be individual plan participants than they were when the rules were enacted.

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[3] This obligation is mirrored under the Internal Revenue Code (IRC) for those advising Individual Retirement Accounts (IRAs).

[4] U.S. Department of Labor. Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables and Graphs (December 2014), http://1.usa.gov/Rp8Bwu.

With no particular financial expertise, these individuals nonetheless bear the full weight of responsibility for determining how best to save and invest for retirement, and they bear the full risks of those investments. It should come as no surprise that many turn to financial professionals for advice. But unlike professional pension fund managers, who at least in theory can be expected to understand the gaps in ERISA and the difference between a sales and an advisory relationship, individual retirement savers typically do *not* distinguish between true fiduciary advisers and those who are regulated as salespeople and take advantage of loopholes to escape ERISA coverage for their "advice." Research has shown, for example, that investors typically cannot distinguish between broker-dealers and investment advisers and that many investors are unable to tell whether their own financial professional is a broker or an adviser even after the differences have been explained to them.[5] Additional survey research has found that retirement plan participants, like investors generally, do not understand the differences in legal obligations among various types of financial professionals and expect all financial advisers to act in their best interest.[6]

Even as the move toward defined contribution retirement plans accelerated in recent years, a hugely profitable new business opportunity emerged, consisting of moving money out of those plans and into Individual Retirement Accounts (IRAs). The opportunity arises when workers change jobs, something the typical worker is expected to do many times over their careers. At that point, a worker who has been saving for retirement through a workplace retirement plan must decide whether to leave their money in their existing plan, move it to their new employer's plan (assuming that is in option), roll it over into an Individual Retirement Account (IRA), or cash out, which can trigger penalties and tax consequences. The current system poses significant challenges for workers who wish to transfer funds between 401(k) accounts, according to an analysis by the Government Accountability Office (GAO).[7] Workers may find it difficult to assess which option would be best for them. Meanwhile, "waiting periods to roll into a new employer plan, complex verification procedures to ensure savings are tax-qualified, wide divergences in plans' paperwork, and inefficient practices for processing" transfers between employer plans all add to the complexity of the process.[8]

If the individual looks to a financial professional for advice, chances are high that the adviser will recommend a rollover, offer to take care of the paperwork for the transfer, and possibly even offer to pay a cash bonus for opening the account. Financial firms that don't manage the 401(k) are eager to capture those assets. After all, even middle income workers who save diligently through a 401(k) plan can manage to amass enough of a nest egg to make them attractive targets for financial firms. Even the firm that operates the employee's current 401(k) plan may have an incentive to roll them out of that plan and into an IRA if, as is often the case,

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[5] Hung, Angela A., Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi and Farrukh Suvankulov. *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*. Santa Monica, CA: RAND Corporation, 2008, http://bit.ly/1OrrZ3v. While this research was conducted in the context of securities laws, it is directly relevant to the issues raised in the DOL rulemaking.

[6] Brown, S. Kathi, *Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants*, AARP Research, September 2013, http://bit.ly/1HO5d5f.

[7] 401(K) PLANS: Labor and IRS Could Improve the Rollover Process for Participants, GOVERNMENT ACCOUNTABILITY, OFFICE, March 7, 2013, http://1.usa.gov/1iQFeOR.

[8] *Id.*

they stand to earn more income from those assets when they are invested outside the workplace plan.

An IRA rollover may at times serve the interests of the worker. This is most likely to be the case when the worker's money is in a workplace plan with a mediocre selection of investment options and the worker is considering rolling over into an IRA at a firm with a strong selection of high-quality, low-cost investment options. More often, however, the opposite is likely to be the case. Investment fees are typically lowest inside 401(k) plans, where investment options are chosen by a plan fiduciary and the plan must be operated exclusively for the benefit of participants. No such protections apply in the IRA market.

Despite the often questionable benefits for retirement savers, rollovers today are responsible for moving trillions of dollars out of ERISA plans and into IRAs. Of the 36 million households that owned traditional IRAs as of May 2013, 49 percent (or nearly 18 million U.S. households) reported that their IRA accounts included rollover assets from another retirement plan.[9] Among traditional IRA-owning households with rollovers, 34 percent had undertaken a rollover since 2010.[10] When workers perform a rollover, they often transfer their entire workplace account balance, which can be a sizeable sum. According to the ICI, 85 percent of households undertaking a rollover since 2010 transferred their entire retirement plan balances into traditional IRAs.[11] Moreover, 87 percent of new traditional IRAs in 2012 were opened exclusively with rollovers.[12] And thirteen times as much money was rolled over into IRAs as was directly contributed to IRAs in 2011, according to the Employee Benefits Research Institute.[13] Boston-based research firm Cerulli Associates estimates that workers rolled over nearly $358 billion from 401(k)s into IRAs in 2013 and that between 2014 and 2018, another $2.1 trillion will follow.[14]

According to the ICI's mid-2014 data, the source of information retirement savers most commonly turned to in making their rollover decision was a professional financial adviser. Advisers were consulted by 61 percent of traditional IRA-owning households that conducted rollovers, with half indicating they primarily relied on a financial professional.[15]

Financial advisers are able to make rollover recommendations based on their own interests, rather than their customers' interests, because the DOL has taken the position that the recommendations are generally not fiduciary investment advice under ERISA.[16] Among other things, they are typically excluded because they constitute one-time advice, albeit the single most important investment decision many workers will make. The 2013 GAO report provides

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[9] Investment Company Institute, 2014 Investment Company Fact Book, A Review of Trends and Activities in the U.S. Investment Company Industry, at 139-140, http://bit.ly/1fFwsEk.
[10] *Id.* at 140.
[11] *Id.*
[12] Investment Company Institute, 2015 Investment Company Fact Book, A Review of Trends and Activities in the U.S. Investment Company Industry, at 153, http://bit.ly/1JfuHVf.
[13] Mark Shoeff Jr., *Navigating 401(k) rollovers*, INVESTMENT NEWS, Mar 2, 2014, http://bit.ly/1j0F3LI.
[14] Jason Zweig, *Who's Training Your Retirement Navigator?*, THE WALL STREET JOURNAL, February 14, 2014, http://on.wsj.com/1hLJxKJ.
[15] *Id.* at 154-55.
[16] DOL Advisory Opinion 2005-23A, http://1.usa.gov/1JO1ggT.

alarming evidence of the tactics that financial services firms engage in through the IRA rollover process to secure workers' assets.[17] For example, financial firms aggressively encouraged rolling 401(k) plan savings into an IRA, and did so with only minimal knowledge of a caller's financial situation. They also often claim that 401(k) plans had extra fees and that IRA's "were free or had no fees," or argued that IRAs were always less expensive, notwithstanding that the opposite is generally true. The report also found that investment firms sometimes offer financial or other incentives to financial advisers who persuade workers to perform a rollover. While some of these practices and the abuses that naturally flow from them could be addressed through better enforcement of existing standards, others are precisely the types of abuses best addressed through application of the ERISA fiduciary standard to rollover transactions.

Both the shift of responsibility for retirement saving onto workers and the trend toward rolling money out of retirement plans into less regulated IRAs have occurred in tandem with a dramatic increase in the complexity of financial markets and financial instruments. Retirement savers today face a dizzying array of investments ranging from the plain vanilla to the exotic. Their options include not only thousands of different mutual funds, but also a wide variety of fixed, variable and equity-indexed annuities, ETFs, REITs, auction rate securities, and more. Many of these products can have highly complex features and cost structures. Evidence suggests that very few retirement savers have the financial expertise necessary to independently assess the available options and determine which are best for them.

2. Many retirement savers lack basic financial literacy skills, prompting them to seek out financial help and making them vulnerable to bad advice when they receive it.

Extensive research has documented the disturbingly low financial literacy levels among Americans. It has been shown, for example, that many adults "do not possess basic knowledge of interest rates, inflation or risk, all of which are essential to making well-informed investment decisions."[18] Indeed, as researchers working in this area have pointed out, successful investing requires financial knowledge beyond the basic financial concepts generally tested for in financial literacy surveys. It also requires, for example, an understanding of such topics as "the relationship between risk and return; how bonds, stocks, and mutual funds work; and asset pricing."[19] Unfortunately, the data here is even less encouraging.

Results of the Financial Capability Survey illustrate the problem.[20] To evaluate financial knowledge, the survey included "a battery of questions covering fundamental concepts of

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[17] 401(K) PLANS: Labor and IRS Could Improve the Rollover Process for Participants, GOVERNMENT ACCOUNTABILITY, OFFICE, March 7, 2013, http://1.usa.gov/1iQFeOR.

[18] Chater, Nick; Huck, Steffen; Inderst, Roman; and Goethe, Johann Wolfgang, *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective,* November 2010. (Coordinated by Decision Technology Ltd with participation by Online Interactive Research Ltd.), http://bit.ly/1RJi4f5.

[19] Lusardi, Annamaria and van Rooij, Maarten, *Financial Literacy: Evidence and Implications for Consumer Education,* November 2009, http://bit.ly/1MCYwT2.

[20] FINRA Investor Education Foundation, *Financial Capability in the United States, National Survey—Executive Summary*, December 2009, http://bit.ly/1JbtPFz. *See also*, Lusardi, Annamaria and Mitchell, Olivia S., *How Ordinary Consumers Make Complex Economic Decisions: Financial Literacy and Retirement Readiness,* September 2009, http://www.nber.org/papers/w15350; and Lusardi, Annamaria and van Rooij, Maarten, *Financial Literacy: Evidence and Implications for Consumer Education,* November 2009, http://bit.ly/1MCYwT2.

economics and finance expressed in everyday life, such as calculations involving interest rates and inflation, principles relating to risk and diversification, the relationship between bond prices and interest rates and the impact that a shorter term can have on total interest payments over the life of a mortgage." Results ranged from a low of 21 percent correct on a question about bond prices to 70 percent correct on a question about mortgages, but "fewer than half of respondents (46 percent) correctly answered both a question about interest rates and a question about inflation. Less than one-third (30 percent) correctly answered those questions plus a question about risk and diversification correctly. And fewer than 10 percent of respondents were able to answer all questions correctly." Moreover, evidence suggests that people overrate their financial knowledge. On the Financial Capability Survey, for example, "most respondents gave themselves high scores."

As the recent financial crisis clearly demonstrated, even some of the most sophisticated institutional investors (pension fund managers among them) lack the financial acumen necessary to accurately assess the risks of the complex and exotic investments available in the market today. Further, as evidence from the Senate's Permanent Subcommittee on Oversight and Investigations made clear, more than a few of these institutional investors proved ill-equipped to defend themselves against aggressive sales practices that often come at their expense.[21] If even sophisticated pension managers are unable to protect themselves from unscrupulous sales tactics, it stands to reason that ordinary investors don't stand a chance without the protections afforded by a fiduciary duty. This is particularly true in light of the heavy reliance that retail investors typically place on the recommendations they get from financial advisers.

Unlike professional fund managers who can reasonably be expected to exert independent investment judgment, individual investors are heavily dependent on the recommendations they receive from financial professionals. A 2006 CFA survey found, for example, that among mutual fund investors who purchased most of their funds from a financial services professional, nearly three in ten said they relied totally on that professional's recommendation without doing any independent evaluation of the fund.[22] Another 36 percent said they relied a great deal on the professional's recommendation but reviewed some written material about the fund before the purchase.[23] According to the survey, women were significantly more likely than men both to value one-on-one expert advice and to act on that advice without doing any additional research.[24] The CFA survey is consistent with other research, including the financial literacy study conducted by Securities and Exchange Commission (SEC),[25] which has found that investors are

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[21] Majority and Minority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,* April 2011, http://1.usa.gov/1RJM4HT.

[22] Roper, Barbara and Brobeck, Stephen, "Mutual Fund Purchase Practices, An Analysis of Survey Results," June 2006, http://bit.ly/1IicqGD.

[23] *Id.*

[24] *Id.*

[25] Staff of the Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors* (As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act), August 2012. *See also*, Siegel & Gale, LLC, *Investor Research Report*, Submitted to the Securities and Exchange Commission on July 26, 2012, http://1.usa.gov/1MfBbss.

heavily reliant on their financial adviser both to explain the disclosures they receive and to recommend a course of action.[26]

Despite the extensive evidence that retirement savers are heavily reliant on the financial professionals they turn to for advice, these individuals may nonetheless find it difficult to prove that a particular recommendation they received from a financial professional was the primary basis for the investment decision they made. It is likely to be even more difficult to prove that there was a mutually understood arrangement between the parties to this effect. Unless there is a written contract between the parties memorializing such an agreement, it is likely to be extremely difficult to prove that any such mutual understanding exists. Moreover, financial professionals may protect against that eventuality by providing disclaimers that their recommendations do not constitute investment advice and that the investor is responsible for making the ultimate investment decision. Alternatively, they may claim that the advice is one-time advice and thus not subject to a fiduciary standard.

These loopholes in the rule's definition of fiduciary investment advice are most likely to be relied on by broker-dealers and insurance agents whose compensation and business practices are most at odds with ERISA's requirement that advice be rendered solely in the interests of the investor. While no one can be considered completely free from conflicts, the sales culture within broker-dealer and insurance firms can be intense. For example, although firms often call their sales reps financial advisors, they typically pay them based not on how well they do for their clients, but on how successful they are in selling investments. Not only do these "advisors" only get paid if their customer executes a transaction, but they will often get paid significantly more to recommend certain investment products over others. In addition, financial firms may set quotas to promote the sale of certain products, base bonuses, payouts or promotions on the adviser's success in meeting those quotas, or otherwise reward advisers for successful sales conduct without regard to its impact on customer well-being.

In light of these intense pressures to sell, the surprise isn't that some sales-based advisers make recommendations that serve their own and the firm's interests rather than the best interests of their customers, but that some do not. As a 2013 Financial Industry Regulatory Authority (FINRA) study of broker-dealer conflicts noted, "While the existence of a conflict does not, *per se,* imply that harm to one party's interests will occur, the history of finance is replete with examples of situations where financial institutions did not manage conflicts of interest fairly."[27] ERISA was designed to protect retirement savers from the bad advice that can result from these sorts of conflicts, eroding the nest eggs retirees must rely on for income throughout their retirement years. Loopholes in the definition of investment advice have rendered it ineffective in providing that protection.

To sum up, the restrictions on the definition of investment advice under ERISA's rules are at direct odds with retirement savers' behavior, needs, and reasonable expectations. These individuals' lack of financial sophistication, their heavy reliance on financial professionals, and their belief that those professionals will act in their best interest all cry out for the protections of

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[26] *See, e.g.*, IFF Research Ltd, *Investment Disclosure Research*, prepared for the Financial Services Authority by IFF Research Ltd. (November 2006), http://bit.ly/1LmSJ6Z.

[27] Financial Industry Regulatory Authority, *Report on Conflicts of Interest*, October 2013, http://bit.ly/1BgWkQm.

a fiduciary standard. But the five-part test in the rule makes it all too easy for sales-based financial professionals whose businesses are replete with conflicts to evade that standard. Moreover, the DOL's current policy with regard to rollover recommendations means that the single most important investment decision many retirees will ever make, a decision that could dramatically affect their ability to afford a secure and independent retirement, is not subject to fiduciary protection. The cumulative effect of these policies is that retirement savers are denied fiduciary protections when they need them most, when the risks are greatest, and when the financial adviser's conflicts of interest are most intense. This is a situation that demands reform.

B. Existing Regulations Do Not Adequately Protect Retirement Savers from the Harmful Impact of Conflicted Advice.

Some have suggested that existing regulations adequately protect retirement savers and that the DOL rulemaking is therefore neither needed nor warranted. In making this argument, they note that broker-dealers are already "heavily" regulated under state and federal securities laws, as well as by FINRA, while insurance agents are already regulated under state insurance laws. They suggest that the current "suitability" standard for broker-dealers already incorporates a best interest obligation that is adequate to ensure that investors' interests are protected. And finally, they point to recent statements from the SEC and FINRA indicating that they will be increasing their scrutiny of practices around rollover recommendations. While increased scrutiny is welcome, it is simply not the case that existing regulations can adequately address abuses, substitute for a strong DOL rule, or justify denying retirement savers the protections Congress intended when it enacted ERISA.

1. Brokers and insurance agents are regulated as salespeople, not advisers.

Despite the fancy titles they adopt, broker-dealer registered representatives and insurance agents are salespeople, and they are regulated accordingly. Broker-dealers are regulated under the Securities Exchange Act of 1934, state securities laws, and the rules of FINRA. Their recommendations to customers are covered both by state unfair and deceptive practices standards and FINRA rules requiring them to "deal fairly" with customers. It is as part of their obligation to deal fairly with customers that brokers are required to make only suitable recommendations. Suitability starts with a "know your customer" rule that requires the broker to use "reasonable diligence" to ascertain the "essential facts" about a customer in order to effectively service the account and comply with all laws, rules, and regulations. The standard is triggered when the broker makes a recommendation about a security or a strategy related to investing in securities.

The suitability standard for retail investors is seen as having three distinct parts.[28] The broker must understand the risks and key features of the investment being recommended and must have a reasonable basis for believing it is appropriate for at least some customers. The broker must also have a reasonable basis for believing the investment is suitable for the particular customer to whom it is being recommended based on that customer's investment

[28] Recommendations to institutional investors are treated differently. While the first and third parts of the suitability standard outlined here would apply, the broker would not be required to determine whether a recommendation is appropriate for that institution if the institution is seen as capable of independently assessing the suitability of the recommendation.

profile. And, in circumstances where the broker has control of a customer account, it is not enough for an individual transaction to be deemed suitable when viewed in isolation. The broker must also evaluate a series of transactions to ensure that they are not excessive or unsuitable when taken together.

Insurance agents, regulated under state insurance laws, are subject to a suitability standard when selling fixed annuities that is modeled on, but somewhat weaker than, the FINRA standard for broker-dealers.[29] Among the most significant differences is the lack of a private right of action for violations of the regulation under the insurance suitability standard.[30] As a result, regulatory action offers the only recourse for victims of unsuitable recommendations. In addition, state regulation puts the primary responsibility for determining suitability on the insurer and the insurance producer, who would logically be expected to be highly motivated to approve the transaction. Moreover, the insurance salesperson is an agent of the insurance company and, as such, owes his or her first duty of loyalty to that company, rather than to the customer. And courts have found that insurance agents are not generally required to provide advice in the best interests of their customers.[31]

Just as loopholes in the ERISA rules defining fiduciary investment advice enable brokers to operate outside its strictures with regard to retirement accounts, gaps in securities laws have allowed broker-dealers to offer extensive investment advice in securities accounts without being regulated as fiduciary advisers. This results not from gaps in the statutes themselves, but from the SEC's lax interpretation of the application of Investment Advisers Act of 1940 to brokers' advisory activities. Brokers' exclusion from the Advisers Act turns on whether they receive "special compensation" for investment advice and whether they give advice that goes beyond that which is "solely incidental to" their brokerage activities. As interpreted and enforced by the SEC, however, this solely incidental to exclusion has given brokers free rein to call themselves financial advisers, offer services they describe as investment and retirement planning, and market themselves as if offering investment advice were their primary function.

2. Suitability is a weaker standard than fiduciary duty.

Clearly, the suitability standard offers protections that go beyond the *caveat emptor* of an unregulated market. However, it is generally agreed, including by those responsible for implementing the rules, that the protections afforded investors under a suitability standard fall short of those offered by the full fiduciary standard appropriately imposed on investment

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[29] Variable annuities are regulated as securities and insurance, while fixed annuities are regulated exclusively as insurance.

[30] *See* National Association of Insurance Commissioners, Suitability in Annuity Transactions Model Rule, Section I. B.

[31] In *Sewell v. Great N. Ins. Co.*, 535 F.3d 1166, 1171 (10th Cir. 2008), the Tenth Circuit held that "absent a special relationship between the insured and the insurer's agent, that agent has no affirmative duty to advise or warn his or her customer of provisions contained in an insurance policy." In *Emerson Electric Co. v. Marsh & McClellan Co.*, 362 S.W.3d 7, 9 (Mo. 2012), the Supreme Court of Missouri held that "[w]hile a broker has a duty to act with reasonable care, skill and diligence in procuring insurance … a broker has no duty to advise the insured about what insurance he needs or what insurance to buy unless it specifically undertakes to do so. This Court, therefore, rejects Emerson's claim that brokers have an additional duty to find insureds the lowest possible cost insurance available to meet their needs."

advice.[32] Key differences relate both to the management of conflicts under the two different standards and to the difference between a suitable recommendation and one that is in the best interest of the customer.

Management of Conflicts: While the fiduciary duty under the Advisers Act is not as stringent as ERISA with regard to management of conflicts, it does at least in theory require advisers to seek to avoid conflicts and appropriately manage those conflicts that are unavoidable. Neither brokers nor insurance agents are subject to a similar overarching obligation to avoid and manage conflicts, although brokers are subject to certain specific restrictions on conflicts such as limits on non-cash compensation. This difference between how suitability and fiduciary duty treat conflicts could be more significant than it is but for the SEC's weak approach to enforcement. Real management of conflicts ought to entail meaningful limitations on practices that can create incentives for advisers to profit at their customers' expense. Instead, the SEC generally appears to default to disclosure as adequate to manage conflicts, even where conflicts are clearly avoidable. The agency has adopted this approach even though there is no evidence that disclosure is effective in protecting investors from the harmful impact of those conflicts, the agency's own financial literacy study demonstrates that investors don't know how to make good use of the disclosures they receive, and some academic research suggests that investors actually experience worse outcomes under a disclosure-based approach to managing conflicts.

Best Interests Standard: Some industry opponents of the rule have argued that there's no need to close gaps in DOL's definition of fiduciary investment advice since FINRA's suitability standard already requires brokers to act in their customers' best interests when they recommend securities transactions or investment strategies to retail investors. Leaving aside the rather obvious point that FINRA rules only apply to securities, and thus by definition cannot substitute for a strong DOL rule, this argument simply does not hold water. Despite the similarity in terminology, there are significant differences between any best interest obligation implied by the suitability standard and a fiduciary duty to act in the best interests of the customer, "without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."[33]

That is not to suggest that there hasn't been progress in recent years to bring the suitability standard into closer alignment with the increasingly advisory role brokers have come to play. Evidence of that can be seen in FINRA's latest update of its standard, which applies the standard both to hold recommendations and to recommendations of investment strategies, not just recommendations of specific transactions.[34] In describing the standard, moreover, the release references case law indicating that a broker's recommendations "must be consistent with his customers' best interests" and notes that this "prohibits a broker from placing his or her interests ahead of the customer's interests."[35]

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[32] Staff Study, U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers*, January 2011, http://1.usa.gov/1VlB4zw.
[33] This language is taken from Section 913 of the Dodd-Frank Act.
[34] FINRA, Regulatory Notice 11-02, Know Your Customer and Suitability, January 2011, http://bit.ly/1LnB6DU.
[35] *Id.*

To support this statement, the release cites a number of cases where FINRA or the SEC has found brokers in violation of suitability because they put their interests ahead of customers', including "a broker whose motivation for recommending one product over another was to receive larger commissions." However, a closer look at the actual cases reveals that a best interest standard is only being cited as a secondary factor in cases that involve more fundamental violations of suitability or fraud. The fact that the broker in question put his interests ahead of the interests of his customers helps to explain the motivation behind the misconduct, but it is not the primary basis for the regulatory action.

Several of the cases cited involve claims based on the inappropriate sale of B shares of mutual funds, where the B shares were more expensive than other share classes for the investor but paid higher compensation to the adviser. These arguably come closest to a "best interest" case, since they allege that the broker recommended an investment option that was more expensive for the customer because it paid him more. However, the suitability claim in these cases turns not on the fact that there were better, less costly investment options available that could have been recommended, but that the *same* investment option was available on terms that were more favorable to the investor. Moreover, the violations in each case went well beyond inappropriate sale of B shares.

The egregious nature of the violations is perhaps best illustrated by an SEC case, *In re Epstein*,[36] which is among those cited as imposing a "best interest" standard. The case involved a broker-dealer, Epstein, who was found to have recommended unsuitable transactions for the accounts of twelve customers, many of whom were elderly, retired, and financially unsophisticated, with a limited understanding of the applicable fee structures and other attributes of the funds that Epstein recommended. The suitability violations in the case involved mutual fund switching as well as the inappropriate sale of Class B shares of mutual funds. Specifically, Epstein was found to have frequently recommended that customers switch from less expensive mutual funds to ones with higher expense ratios, often triggering new Contingent Deferred Sales Charges (CDSC) that could have been avoided through recommendation of other share classes. In some instances, he deprived his clients of the lower expenses to which they would have been entitled had they maintained their investments and their mutual fund holdings had been allowed to mature into less expensive share classes, sometimes missing automatic conversion by a matter of weeks. He also disrupted existing holding periods (or ones that had already phased out) and restarted entirely new CDSC holding periods with higher expenses that would run for several years, including for elderly customers who might not survive the new holding period. In its review of Epstein's disciplinary proceeding, the Commission stated that, "Epstein's misconduct was egregious....[he] exploited his customers' vulnerabilities in making recommendations that clearly were unsuitable for them."

The other cases based on inappropriate sale of B shares also involve violations more egregious than a simple failure to act in the best interests of the customer. In the SEC case, *In re Sathianathan*,[37] for example, the broker-dealer Sathianathan was found liable not only for having

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[36] *In re Scott Epstein*, Securities Exchange Act of 1934, Rel. No. 593428, January 30, 2009, http://1.usa.gov/1CS3uLq.

[37] *In re Raghavan Sathianathan*, Securities Exchange Act of 1934, Rel. No. 54722, November 8, 2006, http://1.usa.gov/1JsjEbs.

recommended that his clients purchase Class B shares of mutual funds when they could have invested in lower-cost Class A shares, but also for recommending that a client, who was an inexperienced and conservative investor, purchase mutual funds and warrants on margin using a concentrated position in stock as collateral. In another case that the industry cites, *In re Belden*,[38] the broker-dealer Belden's recommendation of B shares exposed the investor to tens of thousands in excess charges on a $2 million purchase. If the investor had purchased A shares, the investor's sales charges would have been waived because of the large size of the investment and the investor would have paid 0.75-0.80 percent less per year. Instead, the investor paid roughly $52,000 in unnecessary commissions, then paid $84,000 in contingent deferred sales charges to exchange the B shares for A shares. Despite the fact that several people he worked with said he should put the client into A shares, Belden ignored their recommendations. In his testimony, he acknowledged that his motivation for recommending B shares was the higher commissions they paid and said that he "couldn't stay in business" with lower commissions. In a taped conversation, he said, "I don't deal in A shares."

Three other cases cited to suggest that brokers are already subject to a best interest standard involve similarly egregious suitability violations. In one case, *In re Cody*,[39] the broker-dealer Cody recommended to several investors that they invest significant portions of their portfolios in the mezzanine tranche (eighth in seniority) of mortgage-backed securities. In a clear violation of his obligation under the suitability standard to determine whether the investment was suitable first for any investor and then for his specific customers, he made those recommendations without an understanding of how asset-backed securities are different from conventional fixed income securities, what fundamental factors affect their performance, the risks inherent in the securities, or whether the ABS were suitable for any investor, let alone the investors who sought his advice. Within months the products' credit ratings were downgraded and the investors lost 55 and 65 percent of their investments respectively. Cody's violations didn't stop there. For the next several years, Cody also engaged in a pattern of churning, generating over $40,000 in commissions in one account and $36,000 in the other, with roughly $30,000 of that total going to Cody himself.

In the second case, *In re Daniel R. Howard*,[40] the broker-dealer Howard made unsuitable recommendations to an 85-year-old man who was in poor health, and whose primary need was additional income to pay for his increasing medical expenses. The elderly investor sought investments that carried minimum risk, but Howard put him in speculative "house stocks" in which the brokerage firm made a market. For seven of the ten months at issue, those speculative securities comprised 90 percent of the investor's portfolio. The average holding period for the securities in the investor's account was about 40 days and, on an annualized basis, the account was turned over about 8.5 times. All of these activities were found to be at odds with the investor's stated objectives. After the fact, the broker conceded that his recommendations may have been improper, stating: "[In a high pressure atmosphere like the one that existed at Meyers], you tend to . . . maybe cross over the line. And you tend to maybe make recommendations that,

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[38] *In re Wendell D. Belden*, Securities Exchange Act of 1934, Rel. No. 47859, May 14, 2003, http://1.usa.gov/1CL9Lc5.

[39] *In re Richard G. Cody*, FINRA NACD, Complaint NO. 2005003188901, May 10, 2010, http://bit.ly/1VkOgog.

[40] *In re Daniel R. Howard*, Securities Exchange Act of 1934, Rel. No. 46269, July 26, 2002, http://1.usa.gov/1Ly1tWr.

maybe in hindsight, even though you're tempted to blame other people, and you're tempted to say, well, the client agreed to it or the client authorized it, in the full context that doesn't justify it."

In the third case, *Dep't of Enforcement v. Bendetsen*,[41] the broker-dealer Bendetsen made unsuitable recommendations to a woman in her mid-80s who had approximately $1 million in assets and whose investment objectives were "conservation of capital with stable income" and "long term growth of capital -- income secondary." Despite the fact the investor did not indicate that she was interested in engaging in speculative margin and options trading, did not sign a margin agreement, and was not eligible to engage in options trading under the firm's policies, Bendetsen nonetheless engaged in a series of speculative short sales and option trades on her behalf. As a result of Bendetsen's complicated trading strategies, the net worth of the account decreased from approximately $1 million to approximately $142,000. However, these substantial losses were not readily apparent on the investor's statements because Bendetsen was creating and submitting false account statements showing a much better picture. The hearing panel reviewing his case found that Bendetsen's misconduct was egregious and involved a number of aggravating factors, including highly speculative trading that exposed his elderly and vulnerable client to considerable risk, which resulted in substantial losses, and the fact that he attempted to conceal his client's losses.

While we appreciate the suggestion that brokers should put the interests of their customers first, a reading of these cases simply does not support the contention that brokers are currently being held to a best interest standard by either the SEC or FINRA. Indeed, these cases make the opposite point, calling into question whether suitability is being enforced in a way that provides investor protections beyond a basic fraud standard. These do not appear to be isolated examples. According to *Broker-Dealer Law and Regulation*, written by two of America's leading securities authorities, Norman S. Poser and James A. Fanto: "In many, if not most, suitability cases, the unsuitable recommendations are accompanied by other violations, including failures to supervise, churning, misrepresentations or omissions, and unauthorized trading."[42]

Even financial industry participants have generally come to concede that suitability does not offer the investor protections of a fiduciary "best interest" standard. Thus, SIFMA has come forward with an alternative "best interest" standard that, while it falls well short of a true fiduciary standard, takes as its underlying assumption that brokers should be held to a best interest standard when making recommendations to retail investors.[43] In a recent speech, FINRA Chairman and CEO Richard Ketchum also voiced his support for a best interest standard. At the same time as he emphasized "the effectiveness and fundamental integrity of the present FINRA/SEC regulatory structure for broker-dealers," Ketchum stated that "the clarity of a 'best interest of the customer' standard would be an important step forward in encouraging firm compliance cultures that translate to consistent actions to place the interests of the customer first."[44] Although both Ketchum and SIFMA have stated their support for a best interest standard

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[41] *Dep't of Enforcement v. Bendetsen*, Complaint No. C01020025, August 16, 2004, http://bit.ly/1ebly7u.
[42] Poser, Norman S. and Fanto, James A., "Broker-Dealer Law and Regulation," Aspen Publishers, Fourth Edition, Section 19.01, describing results of the authors' survey of FINRA arbitrations from May 2007 to February 2008.
[43] SIFMA, Proposed Best Interest of the Customer Standard for Broker-Dealers, June 2015, http://bit.ly/1M56eog.
[44] Richard G. Ketchum, Remarks From the 2015 FINRA Annual Conference, May 27, 2015, http://bit.ly/1IdZWUo.

in the context of securities regulation, and have withheld that support in the context of DOL rulemaking, the fundamental point is relevant to the DOL rulemaking as well: the standards currently being applied to recommendations of brokers and insurance agents are not sufficient to constrain conflicts and protect investors from harmful industry practices.

C. Retirement Savers Suffer Real Financial Harm as a Result of Practices that are Legal Under Existing Regulatory Standards.

When financial professionals place their own interests ahead of the interests of their customers, those customers suffer real financial harm. Even advice that complies with a suitability standard can impose significant, unjustified costs on retirement savers, costs that materially reduce their accumulated savings and threaten their ability to afford an independent and secure retirement. Putting even an approximate dollar amount on that harm is challenging, in part because the same financial firms who demand that regulations be justified based on evidence of harm refuse to provide the data that would permit a more complete analysis.[45] Despite these limitations, evidence of the harm suffered by investors, including retirement savers, under the existing regulatory standards is extensive. It takes a variety of forms, including academic studies, observations of industry practices, and basic market analysis.

Drawn primarily from academic research, the Regulatory Impact Analysis prepared by DOL as part of this rulemaking is based on several sound assumptions:

- That financial and other incentives embedded in the business models of broker-dealers and insurance agents affect the recommendations they make.
- That one such effect is a tendency among sales-based advisers to steer retirement savers into investment options with higher underlying costs and poorer performance than other available options.
- That, over the long term, these excess costs and subpar performance materially reduce retirement savers' accumulated savings and, as a result, the income available to them during their retirement years.

The Regulatory Impact Analysis draws heavily on a series of academic studies that show that conflicted advice tends to lead to eroded returns. Perhaps most telling is a 2009 study by Bergstresser, Chalmers, and Tufano which compared returns of mutual funds sold in the direct channel and the broker channel between 1996 and 2004. Without factoring in distribution costs (loads and 12b-1 fees), the authors found poorer performance for funds in the broker channel in three of four categories of funds examined -- domestic equity funds, bond funds, and money market funds. Only among foreign equity funds did broker channel funds outperform direct channel funds over the period analyzed, and the difference in that case was attributable to the performance within a single large mutual fund family. The authors estimated that investors suffered $4.6 billion in reduced returns as a result, on top of paying $9.8 billion a year in 12b-1 fees. They did not estimate the cost of sales loads paid to compensate brokers for their costly

[45] Mark Schoeff Jr., "Industry stiffs DOL on request for IRA data in fiduciary analysis," *Investment News*, March 4, 2012, http://bit.ly/1gJX4nQ.

advice. Another study cited by DOL (Del Guercio and Reuter, 2014) found that broker-sold funds underperform direct-sold funds by an average of 1.15 percentage points per year after accounting for risk and other factors, which the authors attribute to misaligned incentives in the broker-sold market.

Extrapolating from these and other academic studies, the DOL Regulatory Impact Analysis estimates that IRA investors who receive conflicted advice could lose out on $210 billion in retirement savings over the next 10 years and nearly $500 over the next 20 years just with regard to their mutual fund investments. DOL further estimates that an "ERISA plan investor who rolls her retirement savings into an IRA could lose 12 to 24 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser." While industry has taken issue with these estimates, we believe they likely significantly understate the scope of the problem. After all, the academic research on which they are based looks primarily at the portion of the retirement market where transparency is greatest, where regulation is most rigorous, and where the available data is most complete.

A recently released study prepared for the Ontario Securities Commission reaches a similar conclusion with regard to both the negative impact of conflicted advice and the need for regulatory action to resolve the problem.[46] Based on a review of existing research regarding mutual fund fees and compensation, the report finds that funds that pay commissions underperform funds that don't pay commissions "whether looking at raw, risk-adjusted or after-fee returns." It notes, moreover, that the problem is not related simply to commission-based compensation. "While there is no doubt that commissions engender biased advice," the report states, "there is ample evidence that other types of compensation can lead to biased advice as well (e.g., faster promotion for advisors selling more proprietary products)." The report finds "conclusive evidence that commission-based compensation creates problems that must be addressed."

1. Basic market observation provides evidence of investor harm.

Basic market observation leads to the same conclusion: that in many instances today investors are advised to purchase investments that are far inferior to other available options, and that this is done legally, in compliance with existing securities and insurance regulations. Examine the range of investment options that brokers and investment advisers might recommend to retail investors – i.e., a particular class of mutual funds or variable annuities – and the vast differences in the features of these investment products becomes readily apparent. Otherwise similar products may, for example, impose different fees on the investor, or achieve comparable investment results with significant differences in volatility, or provide different guarantees, or, in the case of variable annuities, offer the investor a greater or lesser degree of choice among underlying investment options that are of varying quality. Although all of the options within a particular category may be deemed suitable for a particular investor, these differences in features can profoundly impact costs, risks and overall performance. Investors are harmed when they are encouraged to pay excessive fees, receive substandard performance, or are exposed to

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[46] Weinstein, Edwin. *Mutual Fund Fee Research,* prepared for Ontario Securities Commission on behalf of Canadian Securities Administrators, The Brondesbury Group, Spring 2015, http://bit.ly/1Sx83g4.

unnecessary risks because a broker recommended an investment that, while suitable, was inferior to other available options.

Loopholes in the definition of fiduciary investment advice under both ERISA and securities laws leave investors vulnerable to this harm. The most readily observable evidence of such harm arises out of the significantly different costs imposed by otherwise similar investments. An adviser operating under a well enforced fiduciary standard must take costs into account when determining which investment is best for the customer.[47] A broker or insurance agent operating under a suitability standard generally does not have to give costs the same consideration; they may legally recommend a higher cost option that compensates them better if the investment itself is generally suitable.

When CFA commented on the Securities and Exchange Commission's Request for Information in July of 2013,[48] we included an analysis of costs of S&P 500 index funds to illustrate the wide range of costs among otherwise virtually identical products and the generally higher costs among broker-sold funds. We focused on index funds because they offer the cleanest example. While minimizing costs is important in all fund types, there is simply no justification for paying high costs in a fund that is designed simply to match the performance of an index.

If you look at data regarding S&P 500 index funds, two things are immediately apparently. The large majority of investor assets in funds purchased outside retirement plans[49] are held in a handful of very low-cost, direct-marketed funds managed by Vanguard ($139.593 billion), Fidelity ($58.497 billion), T. Rowe Price ($17.699 billion), and Schwab ($15.446 billion).[50] No single broker-sold fund comes close to matching these funds for level of assets under management, and even on an aggregated basis S&P 500 index funds sold by brokers to investors outside retirement plans appear to have far fewer assets under management. When brokers do sell S&P 500 index funds outside retirement plans, those funds appear to carry higher administrative costs than direct-marketed funds, even after the cost of compensating the broker is excluded. This is consistent with the findings of the academic research on which DOL's estimate of harm is based.

In conducting our analysis, we erred on the side of understating such costs by subtracting all 12b-1 fees from the expense ratio. According to the data provided by Morningstar, net expense ratios among the largest direct-marketed funds range from a low of 0.06 percent for the Fidelity Spartan 500 Index Advantage fund to a high of 0.29 percent for the T. Rowe Price Equity Index 500 Fund. While a few no load funds on the Morningstar list have net expense

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[47] We focus on the potential impact of a *well enforced* fiduciary duty because there is little evidence that the SEC actually enforces the securities law fiduciary duty in a way that affords investors the full benefits the fiduciary duty ought to provide.

[48] Letter from CFA Director of Investor Protection Barbara Roper to SEC Secretary Elizabeth M. Murphy regarding "Duties of Brokers, Dealers, and Investment Advisers" (File Number 4-606), July 5, 2013, http://bit.ly/1Jslglq. (Hereinafter, CFA July 2013 SEC comment letter)

[49] Because we conducted this analysis for a comment on a possible SEC fiduciary rule, we focused on funds held outside workplace retirement plans, including but not limited to funds sold to IRA investors.

[50] This data was supplied by Morningstar, which provided a list of S&P 500 index funds ranked by assets under management and excluding share classes sold through retirement plans or to non-retail investors.

ratios as high as 0.50 or 0.60 percent, most are significantly lower, as one would expect in a competitive market where costs are directly related to performance.

A number of broker-sold funds also have competitive administrative fees, once the broker's compensation is subtracted. But others do not. In these cases, the "benefit" the investor received from investing through a broker is advice to put their money into an index funds with expenses several times higher than the best available funds. The following are a few examples taken from the Morningstar data:

- Investors in the Wells Fargo Advantage Index A pay a maximum front load of 5.75 percent for an S&P 500 index fund with a current net expense ratio of 0.56 percent (0.68 gross). That is roughly twice as high as the expense ratio of the highest cost of the large direct-marketed funds and ten times the expense ratio of the lowest-cost fund. Investors have over $400 million invested in this share class of the fund.[51]

- Investors hold nearly $600 million in A shares of the J.P. Morgan Equity Index Fund. This fund charges a maximum front load of 5.25 percent for a fund with a net expense ratio of 0.45 percent (including .25 percent in 12b-1 fees) and a gross expense ratio of 0.94 percent.

- A total of about $739 million is invested in a series of State Farm S&P 500 index funds, including two A share funds and two B share funds. The bulk of that money (about $564 million) is invested in the A shares, which have maximum front loads of 3.0 and 5.0 percent and net expense ratios of 0.77 percent.[52]

- An even more extreme example is offered by the Rydex S&P 500 Fund. Investors have approximately $349 million invested in the largest share class of this fund, which has a net expense ratio of 1.5 percent (including 12b-1 fees of 0.25 percent). That is roughly 20 times the expense ratio on the Fidelity fund and 10 times the expense ratio on the Vanguard fund.

There is nothing inherently more expensive about operating a broker-sold S&P 500 index fund than a direct-marketed fund (other than the cost of compensating the broker, which CFA subtracted from the administrative fee for the purposes of its analysis). Moreover, major market players such as Wells Fargo, J.P. Morgan, and State Farm all have a broad enough customer base that they should be able to offer a competitive product, if they chose to do so. The logical conclusion, therefore, is that the higher fees in broker-sold funds reflect a market where competition is based primarily on factors other than cost. Given the singular role that reducing costs plays in determining performance in index funds, the pressure to keep costs low would arguably be greatest here. Thus, there is every reason to believe that the lack of cost competition evident among broker-sold S&P 500 index funds has the same impact on the sale of other types

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[51] Some of these investors may have paid lower than the maximum front load, because of breakpoints for example, but we believe the basic point still holds. These investors are paying a premium for questionable advice.

[52] Far less money is held in the B shares, which have maximum deferred loads of 3.0 and 5.0 percent and net expense ratios of 1.17 (including a 0.65 percent 12b-1 fee) and 1.47 percent (including a 0.95 percent 12b-1 fee). This may reflect that expenses of that magnitude are difficult to justify even under a suitability standard.

of investment products that can be sold on the basis of features other than cost alone. As noted by Dr. Michael Finke in the Investment Management Consultants Association (IMCA) comment letter on the SEC request for information,[53] this lack of cost competition among broker-sold funds permitted under the suitability standard may help to explain why broker-recommended mutual funds significantly underperform direct-sold funds more commonly recommended by investment advisers operating under a fiduciary standard.

As the DOL has noted in its Regulatory Impact Analysis, excess fees paid by investors who invest based on the recommendation of a conflicted adviser can have a significant impact on the long-term savings of retirement savers. The SEC made a similar point when it warned in a recent bulletin for investors, "Over time, even ongoing fees that are small can have a big impact on your investment portfolio," reducing returns, shrinking a nest egg, and preventing investors from achieving financial goals.[54] This impact was vividly illustrated in an October 2013 Bloomberg Markets Magazine report regarding data filed with the SEC which showed that "89 percent of the $11.51 billion of gains in 63 managed-futures funds went to fees, commissions, and expenses during the decade from Jan. 1, 2003 to Dec. 31, 2012."[55] As the Bloomberg article noted, brokers have an incentive to keep clients in managed-futures funds, even when it is not in the best interests of the client, because they receive annual commissions of up to 4 percent of assets invested and investors pay as much as 9 percent in total fees each year.[56]

While they are important, excess costs are not the only concern associated with advice delivered outside the protections of a fiduciary standard. In our comment letter to the SEC, we also looked at ratings of variable annuities by independent analyst Weiss Ratings to help to illustrate how factors other than just costs can and should be incorporated in recommendations based on a best interest standard.[57] While cost is one factor Weiss incorporates into its ratings, it also includes the availability of a wide selection of mutual fund subaccounts with good performance and the financial strength of the insurance company issuing the annuity. In explaining the basis for arriving at its 10 best list, for example, Weiss explained that, "mutual fund subaccount performance played an important role in the selection process. After all, a variable annuity can have low costs and a strong Financial Strength Rating, while at the same time offering only mediocre fund performance." Lack of fund choice and high surrender fees were clearly also major factors in determining which annuities ended up on Weiss's 10 worst list.

A look at the annuities on Weiss Ratings' 10 worst list again raises the question of whether these funds could even exist in a market where sellers were subject to a best interest standard. For example, the list included two versions of the Polaris Preferred Solution annuity, offered by SunAmerica. Both of the versions on Weiss's list included just one fund option, which Weiss described as "weak," and both charged high surrender fees: 9 percent decreasing

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[53] Dr. Michael Finke, "Fiduciary Standard: Findings from Academic Literature," attached to the letter from IMCA, July 5, 2013 to the SEC in response to the request for comments on the "Duties of Brokers, Dealers and Investment Advisers," http://1.usa.gov/1KgdRZu (hereinafter "Finke Study").

[54] U.S. Securities and Exchange Commission Investor Bulletin: "How Fees and Expenses Affect Your Investment Portfolio," February 19, 2014, *http://1.usa.gov/1J6rpmm.*

[55] David Evans, "How Investors Lose 89 Percent of Gains from Futures Funds," Bloomberg Markets Magazine, Oct. 7, 2013, http://bloom.bg/1JbuuHh.

[56] *Id.*

[57] *See* Weiss Ratings Best and Worst Variable Annuities, http://bit.ly/1fhAtOy.

over 9 years for the Bonus Fund and 8 percent decreasing over 4 years for the L shares. A separate site, Annuity Digest, listed Polaris Preferred Solution as offering a choice of 50 funds,[58] with maximum total expenses of nearly 3 percent, including a maximum mortality and expense risk charge (M&E fee) of 1.15 percent.[59] According to Annuity Digest, the annuity also imposed an 8 percent surrender charge decreasing over 8 years and a maximum commission of 7.5 percent. By way of comparison, Annuity Digest lists a number of funds with M&E charges in the 0.2 to 0.4 range, for example, and a number which charge no commissions and no surrender fees. No adviser who was truly motivated by the best interests of his or her customer could justify recommending options such as those on the 10 worst list when high quality, lower cost alternatives are readily available.

2. Risks of harm are greatest when workers change jobs or leave the workforce.

Retirement savers are arguably at greatest risk from the harmful impact of conflicted advice when they change jobs or leave the workforce to enter retirement and must decide what to do with the money they have accumulated in a workplace retirement plan. Even those earning relatively modest incomes can suddenly become attractive targets for financial services firms if they've managed to accumulate twenty or thirty thousand dollars or more in a workplace plan. This can be true even for the financial firm that manages the retirement plan if, as is often the case, that firm charges higher management fees for funds sold outside the plan than it does on plan offerings. With trillions of dollars up for grabs from retirement savers making job changes or leaving the workforce, even reputable firms have been shown to engage in aggressive tactics to entice workers to move money out of their pensions and 401(k) plans and into IRAs.

While the ability to siphon trillions of dollars out of workplace plans has been enormously profitable for financial firms, it can be significantly less financially advantageous for those retirement savers who are persuaded to roll their money out of an ERISA plan and into an IRA. Data from the Investment Company Institute (ICI) documents this cost disparity with regard to mutual funds. ICI data indicates that, while average-weighted costs of funds purchased in IRAs are lower than overall fund costs, the average-weighted costs of funds sold through 401(k)s are lower still.[60] Cost disparities are likely to be even greater for investors who are rolled over into a fixed index or variable annuity. Those cost differences can have a major impact on long-term investments.

As noted above, DOL estimates that an investor who rolls her retirement savings into an IRA could lose 12 to 24 percent of the value of her savings over 30 years of retirement as a result of conflicted advice. That estimate is based on research which indicates significant underperformance among broker-sold investments. While industry has taken exception to this estimate, it is based on far from the most extreme example. Here again, real world examples help to illustrate the nature and extent of the harm that investors can and do suffer as a result of conflicted advice.

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[58] We were unable to determine the reason for the disparity.
[59] *See* Annuity Digest profile of the SunAmerica Polaris Preferred Solution annuity, http://bit.ly/1DqdqH0.
[60] Brian Reid, "Getting the Numbers Right on Investment Advice for Retirement Savers," ICI Viewpoints, February 26, 2015, http://bit.ly/1Kg448s.

A recent blog by Joseph M. Belth provides a vivid picture of the kind of abuse that can occur.[61] The blog describes the case of a 78-year-old woman whom he calls Beatrice who was persuaded to roll over her retirement accumulation at College Retirement Equities Fund (CREF) into an IRA containing a variable annuity issued by Guardian Insurance & Annuity Company, a subsidiary of Guardian Life Insurance Company of America. According to Belth's account, which is based in part on an earlier blog by fee-only insurance adviser and actuary Scott Witt, Beatrice was paying expenses of just 41 basis points (0.41 percent) on her CREF investment. That adds up to roughly $1,350 a year in expenses on her $325,000 balance. In contrast, the Guardian annuity her money was rolled into imposed 110 basis points of annual mortality and expense charges, 75 basis points of annual investment expense charges, and 20 basis points of annual administrative expense charges for a total of 205 basis points (2.05 percent), totaling about $6,450 a year. Adding to the cost, the adviser sold 78-year-old Beatrice a rider guaranteeing that the eventual lifetime income from the annuity would be enhanced significantly if she avoided making withdrawals for ten years. The annual cost of the enhanced lifetime income guarantee was 115 basis points, bringing the total cost to 325 basis points (3.25 percent), or about $10,650 a year.

As if that weren't enough, the adviser rolled over the full $325,000 accumulation in Beatrice's CREF account, rather than the $200,000 she had authorized, in what the adviser later claimed was a paperwork error. As a result of that "paperwork error," Beatrice was forced to take required minimum distributions from the annuity in order to avoid draconian income tax penalties. Doing so caused her to forfeit the entire lifetime income guarantee for which she was paying roughly $4,800 a year. When Beatrice, with the help of Witt, took her concerns to the company and asked for her investment to be refunded minus a $31,000 surrender charge, the initial response from Park Avenue Securities, which employed the adviser who sold Beatrice the annuity, was to refuse the claim, saying it found no evidence of wrong-doing on the part of the adviser. It noted, among other reasons, that she had received a prospectus and hadn't asked for a refund within the allotted look-back period. It was only after Belth contacted Guardian, indicating that he was planning to write about the case on his blog, that the company agreed to settle the case on terms that are confidential.

3. Less wealthy, less sophisticated individuals are most likely to be targets of harmful practices.

Evidence suggests that less sophisticated and less wealthy investors are most likely to suffer the harmful consequences of recommendations that are not based on the best interest of the investor. In a comment letter filed by IMCA with the SEC in response to its Request for Information, Dr. Michael Finke, a professor at Texas Tech University, cited academic studies bearing evidence of this effect:

- A 2012 study found that commission-compensated insurance agents "will consistently recommend higher commission products to less sophisticated consumers, leading to welfare losses that are greatest among those who can least afford to sustain them."[62]

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[61] Joseph M. Belth,"Guardian Life Rectifies an Unsuitable Rollover," June 22, 2015, http://bit.ly/1JcccFE.
[62] Finke Study at 6 (citing S. Anagol, S. and H.H. Kim, 2012, "The Impact of Shrouded Fees: Evidence from a Natural Experiment in the Indian Mutual Funds Market," American Economic Review, 102(1): 576-593).

- An earlier study similarly examined financial firms' "incentive to shroud attributes."[63] The researchers described how producers "will rationally segment the market by level of investor sophistication," with less efficient, more opaque products created to "maximize economic rents from less sophisticated consumers" while more competitive products are simultaneously offered to sophisticated consumers. "Examples of product differentiation through opaque characteristics are evident in the mutual fund market."

- Another study cited by Dr. Finke describes how fund companies use different tactics to attract "less sophisticated investors, who fund families attract through marketing, and more sophisticated, direct-channel investors who are targeted through higher performance."[64]

- This is consistent, Dr. Finke suggests, with evidence from a separate academic study "that successful mutual funds appear either to gain market share through lower expenses or by increasing opaque fees which are then used to incent advisor recommendations."[65]

- Finally, Dr. Finke cites research suggesting that the "latitude of recommendation quality allowed in a suitability model is particularly troubling when clients are older and have experienced cognitive decline that may reduce their ability to perceive self-serving recommendations."[66]

In other words, while opposition to fiduciary rulemaking is often presented as being motivated by concern over the well-being of middle-income retirement savers, the academic literature strongly suggests that it is precisely these less wealthy, often less financially sophisticated individuals who are most at risk from harmful practices permitted under existing securities and insurance regulations and who would benefit most from adoption of a rule closing loopholes in the definition of fiduciary investment advice under ERISA.

D. Contrary to Industry Claims, Non-fiduciary Advice is Often Far More Costly than Advice from Fiduciary Advisers.

Financial firms that rely on sales-based compensation have argued that, far from benefiting retirement savers, closing loopholes in the definition of investment advice could drive up the cost of advice, potentially leaving low- and middle-income retirement savers without access to the guidance they need to navigate complex investment decisions. Lack of transparency around the compensation of sales-based advisers helps to maintain this myth that they offer more affordable services than fiduciary advisers. While there are certainly circumstances in which commission-based accounts are more affordable, this is far from universally true.

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[63] Finke Study at 7 (citing X. Gabaix and D. Laibson, 2006, "Shrouded attributes, consumer myopia, and information suppression in competitive markets," Quarterly Journal of Economics, 121(2), 505-540).
[64] Finke Study at 7 (citing N.M. Stoughton, Y. Wu and J. Zechner, 2011, "Intermediated investment management," The Journal of Finance, 66(3), 947-980).
[65] Finke Study at 7 (citing A. Khorana and H. Servaes, 2012, "What drives market share in the mutual fund industry?" Review of Finance, 16, 81-113).
[66] Finke Study at 6 (citing M.S. Finke and T. Langdon, 2012, "The impact of a broker-dealer fiduciary standard on financial advice," Journal of Financial Planning, 25(7), 28-37).

In assessing the affordability of advisory services, it is important to look at total costs to the investor. First, there is the cost of the advisory services themselves. Second, there is the cost of the investments recommended to implement the advice. In addition, it is important to consider what services the investor receives in return for their payment. When the full costs to the investor are computed, the costs of commission-based advice are often higher. In other cases, retirement savers who pay for advice through sales-based fees pay roughly the same amount as is typically charged by fiduciary advisers but receive a lower level of service in return for that payment.

For example, the one percent asset under management fee directly charged by many fiduciary advisers is equivalent to the one percent 12b-1 fee indirectly charged by many brokers. In return, the broker's customers get a one-time transactional recommendation with no on-going duty of care, but they continue to pay the annual one percent fee for as long as they hold the investment. In contrast, the adviser's customers get ongoing account management and, in many cases, comprehensive financial planning for the same one percent annual fee. While the adviser's fees are fully transparent, the broker's fees are hidden in the expense ratio of the recommended investment. This creates the false impression that the broker's services are more affordable when, in fact, the customer is paying the same amount for a lower level of service. If, as the evidence suggests is often the case, the broker also recommends funds with higher expenses, even after the cost of compensating the broker is subtracted, then the increased cost to the investor for non-fiduciary advice are that much higher.

One case where the costs of brokerage services are clearly and unequivocally lower are for a buy-and-hold investor who trades in individual stocks and trades infrequently. Here, the rock bottom prices available for executing stock trades would be hard to match by an adviser charging a typical one percent assets under management fee. This is not, however, a common scenario, particularly for smaller savers, since few investors have sufficient assets that they can get adequately diversified investing in individual stocks. Moreover, even here where the cost benefits of a commission-based accounts are most apparent, some investors may prefer to pay an adviser a management fee in return for the on-going portfolio management they would receive from a fiduciary adviser.

A far more common scenario is the retirement saver with $5,000 to contribute to an IRA. As rule opponents often point out, advisers who charge fees based on assets under management would be unlikely to serve this client, but other options would be available. The retirement saver could get a recommendation from a broker-dealer, invest the money through a robo-adviser, or pay an hourly fee for a recommendation from a fee-only adviser who specializes in serving middle income clients. Of these options, the broker-dealer recommendation is likely to be most costly, with the magnitude of that increased cost dependent on the particular investment recommended.

A few concrete examples can help to illustrate this point. In each case, we assume a one-time investment of $5,000, a 5 percent annual return, and a holding period of 10 years.

- Assume the retirement saver consults a broker, who recommends A shares of an actively managed mutual fund with a fairly standard 0.99 percent expense ratio (including a 0.25

percent 12b-1 fee). Given the small size of the investment, the saver is unlikely to qualify for breakpoints and thus would pay the maximum 5.75 percent front load charged by the fund, or $287.50 right off the top. Assuming a 5 percent annual return, that investor will have paid approximately **$850 in total costs and the investor's balance will be approximately $6,950 at the end of 10 years.**[67]

- If that same investor is recommended a lower cost option, with a 0.75 percent expense ratio, for example, but the same 5.75 percent front load, the investor will have paid approximately **$720 in total costs after 10 years, and the investor's balance will be approximately $7,120.** On the other hand, if the investor is placed in a higher-cost alternative, with a 5.75 percent front load and a 1.3 percent expense ratio, the investor **will have paid approximately $1,020 in total costs, and the investor's balance will be just $6,740.**

- In some cases, although they are more appropriate for a short-term investment, a broker might recommend C shares, which compensate the broker through a 12b-1 fee (typically 100 basis points) included in the expense ratio. An investor who purchases C shares with no front load but a 1.74 percent expense ratio will have paid approximately **$1,020 in total costs after 10 years, and the investor's balance will be approximately $6,850.**

- If the saver invests the money through a robo-adviser, the costs would be dramatically lower. Using Wealthfront as an example, a retirement saver with $5,000 to invest would pay nothing for the advice (Wealthfront advisory services are free for accounts below $10,000) and annual expenses of between 0.1 percent and 0.3 percent on the Exchange-Traded Funds (ETFs) in which the money would be invested. Assuming a weighted average expense of 0.2 percent and a weighted average bid-ask spread of 0.1 percent, the saver will have paid approximately **$130 in total costs at the end of 10 years, and the investor's balance will be approximately $7,980.**

- Finally, the investor who prefers face-to-face interaction could hire a fee-only planner who charges an hourly fee. Assuming the investor pays an hourly rate of $250 for an hour of the planner's time, and the planner structures the investor's account with the same ultra low cost ETFs discussed above (weighted average expense ratio of 0.2 percent plus a weighted average bid ask spread of 0.1 percent), the investor will have paid approximately **$380 in total costs at the end of 10 years, and the investor's balance will be approximately $7,580.**

Thus, a retirement saver could pay significantly different amounts for a one-time $5,000 investment over 10 years, depending on what advisory services are used. Those costs can range from approximately $130 for a robo-adviser to $1,020 for a broker. And, the higher the cost, the lower the retirement saver's ultimate portfolio balance, with the broker-sold funds resulting in substantially lower final balances compared to balances that result from working with a robo-adviser or fee-only financial planner.

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[67] These examples were developed using the FINRA mutual fund expense calculator and actual funds available in the market today.

Retirement savers have even more options when they have larger amounts to invest. Consider, for example, the options available to an individual who has just left her job and has $100,000 saved in the company 401(k) plan. Often, the individual's best option will be to leave the money in the 401(k), where the plan sponsor is likely to have negotiated access to institutional shares with expenses that are lower than those available in the retail market.

- Assume, for example, that a worker is paying a 0.58 annual expense ratio on her 401(k) investments, which was the average cost of a 401(k) stock fund in 2013, according to the Investment Company Institute, and receives a 5 percent annual rate of return. If she leaves the money in her 401(k) for 20 years, she will pay approximately **$18,400 in total costs, and her balance will be approximately $236,200 at the end of that time.**

- Few broker-dealers could match those low costs, yet many if not most would not hesitate to recommend that she roll her money over into an IRA. Assume, for example, that the broker recommends A shares of the actively managed mutual fund discussed above with a 0.99 percent expense ratio. With $100,000 to invest, the investor would qualify for a reduced front load of 3.75 percent. At the end of 20 years, the investor will have paid approximately **$32,500 in total costs and the investor's balance will be approximately $209,500.** That's $14,200 more in fees than the investor would have paid if she'd left the money in her 401(k) plan, and it leaves her with $26,700 less in her retirement account.

- Even if the broker recommends A shares of a relatively low-cost actively managed fund, with an expense ratio of 0.75 percent, the investor would pay **$26,000 in total costs, and the investor's balance will be approximately $220,400 after 20 years.** While this is a significant improvement, it still would cost the investor approximately $7,600 more than she would have paid if she had left the money in her 401(k) and would leave her with a total balance that is approximately $15,900 lower than she would have achieved staying in the plan.

- If, on the other hand, the broker were to recommend C shares with an expense ratio of 1.74 percent (including a 100 basis point annual 12b-1 fee), the investor will have paid approximately **$48,400 in total costs after 20 years, and the investor's balance will be approximately $187,400.** That's nearly $30,000 more in fees than she would have paid if she left the money in her 401(k), lowering her account balance by approximately $48,900.

Not every rollover exposes the investor to higher costs, however. A rollover into a portfolio of very low-cost no load index funds could save the investor money, particularly if the investor is in a 401(k) plan with higher than average costs. So could advice from either a robo-adviser or low-cost fee-only adviser.

- Assume the investor uses Betterment, another robo-adviser that puts its clients into a portfolio of very low-cost ETFs. Betterment charges a 0.15 percent management fee for accounts over $100,000. If it implements through a portfolio of ETFs with weighted expenses of 0.2 percent and weighted bid-ask spread of 0.1 percent, the investor will have paid approximately **$11,500 in total costs after 20 years, and the investor's balance**

will be approximately $247,000. Thus, the investor who rolls over her 401(k) into an account at Betterment could actually save $6,900 relative to what she would have paid in fees if she left the money in her 401(k), potentially increasing her total balance by approximately $10,800.

- An investor who chose to roll over her 401(k) into an IRA based on advice from a planner who charges an hourly fee could also potentially reduce her costs and increase her account balance. Assuming that the investor pays an hourly rate of $250 per hour and spends three hours each year with the planner, and further assuming that the investor invests in a portfolio of low-cost ETFs, the investor could expect to pay roughly **$15,000 for the advice over 20 years and $6,720 in fund expenses**. If the investor paid for the advice out-of-pocket, their total account balance at the end of 20 years would be about $255,000.

As these examples help to illustrate, not only is it possible to offer affordable advice under a fiduciary standard, but advice from a fiduciary will often be significantly more affordable than non-fiduciary advice when the total costs to the investor are taken into account. Finally, we made all these comparisons using fairly standard costs for brokerage recommendations. If the broker or insurance agent recommended an annuity, which often combine very high commissions with very high annual expenses, the differences in affordability of fiduciary and non-fiduciary advice would be that much greater. Small savers who need to make every dollar count when saving for retirement would benefit most from a rule that stands to reduce excess costs such as these.

E. A Well-designed Rule Can Harness Market Forces to Benefit, Rather than Harm, Retirement Savers.

In discussions of the proposed rule, much of the focus has been on how it would change interactions between retirement savers and the financial professionals they turn to for advice. Its potential to change the way financial professionals make decisions about what investments they recommend is certainly a vitally important aspect of the rule proposal. But at least as important is the rule's potential to change the way product sponsors compete, and specifically its potential to harness market forces to benefit, rather than harm, retirement savers. Currently, some investment product sponsors compete based on cost and quality. This is evident from the fact that, in any category of investments you consider, there are options available that offer a high quality investment at a highly reasonable price. And some financial advisers, motivated by their customers' best interests, recommend those investments. It is also true, however, that in every category of investments, there are options available that offer a low-quality or mediocre investment at a very high price. And some financial advisers, motivated by a host of financial and other incentives, recommend those options to their customers. They are able to do so legally under a regulatory system that requires them to make suitable, but not best interest, recommendations.

By imposing a best interest obligation on advisers, and backing it with tough restrictions on practices that undermine that standard, the DOL rule proposal has the potential to change the terms on which product sponsors compete. Those that currently compete by offering lucrative

financial incentives to sales-based advisers will have to adapt or risk losing market share under a rule that requires investment products to compete based on serving the best interests of the retirement saver. Those that already offer a high quality investment product at a reasonable price would be rewarded. Increased cost competition should help to bring down excess costs across the market, and inferior investments that fail to make substantial improvements in quality should eventually be culled from the market. That one change has the potential to deliver dramatic benefits to investors in the form of reduced costs, reduced exposure to unnecessary risks, and improved long-term performance.

II. Conflict of Interest Rule

A. CFA Strongly Supports Proposed Changes to the Definition of Fiduciary Investment Advice.

As discussed above, the current regulatory definition of fiduciary investment advice includes a five-part test that dramatically narrows the definition beyond what Congress intended when it enacted ERISA. This problem is exacerbated by the current staff interpretation that rollover recommendations do not constitute fiduciary investment advice under ERISA. The result is that services that retirement savers perceive and rely on as advice, including recommendations regarding the most important financial decisions many will ever make, fall outside the regulatory protections Congress intended to provide when it imposed a strict fiduciary duty on investment advice to retirement plans and plan participants. Sales-based advisers, including broker-dealers and insurance agents who are not subject to a fiduciary duty under applicable non-ERISA regulatory regimes, are able to exploit these gaps in ERISA regulations to make recommendations to retirement savers that place their own financial interests ahead of those of their customers. All too often, workers' and retirees' ability to afford a secure and independent retirement is put at risk by conflicted advisers' recommendations to invest in high-cost retirement investments that suffer subpar performance and expose the saver to unnecessary risks.

A crucial first step to address this problem is to revise the definition of fiduciary investment advice under ERISA to bring that definition into better alignment with the statute upon which it is based. For the most part, the revised definition proposed by DOL does just that. We are particularly encouraged that the proposed rule replaces the five-part test with a functional definition of investment advice and that it clearly and unequivocally covers recommendations with regard to rollovers. Both are elements we had previously identified as critically important to the rule's effectiveness. Our one concern, discussed further below, is its inclusion of a requirement that the advice be provided "*pursuant to an agreement, arrangement, or understanding* that the advice is individualized or specifically directed to the recipient for consideration in making investment or investment management decisions regarding plan assets." (emphasis added) Absent further clarification from DOL, we are concerned that this requirement could be used by conflicted advisers in the same way that the current "mutual understanding" requirement is used to evade their fiduciary obligations to retirement advice recipients.

1. The rule proposal appropriately defines the conduct that would constitute fiduciary investment advice.

The proposed rule enumerates four categories of advice that would constitute investment advice subject to a fiduciary duty absent a carve-out and if provided in return for direct or indirect compensation. They are:

- recommendations regarding the advisability of "acquiring, holding, disposing of or exchanging securities or other property," including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA;

- recommendations regarding the management of securities or other properties, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;

- an appraisal or fairness opinion regarding the value of securities or other property if provided in connection with a specific transaction involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA; and

- recommendation of a person to provide any of these services for compensation.

In addition to requiring that the financial professional be compensated for the advice, the definition specifies that the recommendations must be "directed to a specific recipient for consideration in making investment decisions."

In perhaps the most significant of several improvements in the rule over the original 2010 proposal, it makes clear that recommendations regarding whether to take a distribution of benefits or move money out of a retirement plan would be considered fiduciary investment advice, as would advice with regard to how to invest any money that is rolled over or otherwise distributed from a plan. As we have noted many times, decisions regarding whether to move money out of a retirement plan and how to invest the funds when a rollover is elected are among the most important and challenging decisions that retirement savers are likely to face. Those who are early in their careers can lose out on tens or hundreds of thousands of dollars in retirement savings if they choose unnecessarily costly investments that erode their savings over time. Those at or near retirement face even greater risks, since they have little ability to recover from mistakes that could materially affect their quality of life in retirement. Moreover, as discussed above, this is the point not just of ultimate vulnerability for the retirement saver, it is also the point of maximum risk, since it is often the first time average workers and retirees have sufficient savings amassed to make them attractive targets for financial advisers eager to profit at their expense. It is for this reason that including advice about rollovers and benefit distributions in the definition of fiduciary investment advice is of such crucial importance. We applaud the DOL for making this important improvement to the rule proposal and urge the Department not to waver on this point in the face of self-interested industry lobbying to scale back the scope of the rule.

2. The revised definition is a functional definition that is consistent with the securities law definition of investment advice.

The revised definition is a functional definition that closely resembles the broadly inclusive securities law definition of investment advice but without its limitation of applying only to securities transactions. It makes the same distinction made under the securities laws between generalized information and particularized recommendations.[68] It does this, first and foremost, by equating recommendations with advice. This equation of recommendations with advice is consistent with how financial firms portray themselves and their services, and it is consistent with how investors perceive those services.

It has been many years since broker-dealers routinely labeled their representatives as sales reps or insurance companies routinely called their annuities salespeople insurance agents. Instead, over the last several decades, broker-dealer registered representatives, insurance agents and others have increasingly adopted titles such as "financial advisor," "financial consultant," and "financial planner" to convey to prospective customers that they offer services that go beyond mere sales recommendations. Moreover, these "advisers" typically label their recommendations as investment planning and retirement planning and market those services as if they were designed to put the customer's interests first. We first commented on this phenomenon in a letter to the SEC in 2000 in which we urged the agency to close the loophole that enabled brokers to market themselves as advisers without being regulated accordingly, but the practice was at least a decade old at that time.[69] PIABA documents similar practices today in a report that contrasts financial firms' advertising practices with their claims regarding their legal obligations in arbitration.[70] Furthermore, survey after survey has shown that investors do not distinguish between the sales recommendations they receive from broker-dealers and insurance agents and the advice they receive from fiduciary advisers.[71]

This approach of equating individualized recommendations with advice is also an approach that has received broad support in the context of SEC fiduciary rulemaking. In its comment on the SEC's Section 913 study, for example, SIFMA proposed a definition of investment advice that would capture "investment recommendations that are provided to address the objectives or needs of a specific retail customer after taking into account the retail customer's specific circumstances."[72] As we noted in a subsequent comment to the SEC, as long as it

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[68] An investment adviser is defined under the Investment Advisers Act of 1940 as someone who is in the business of giving advice about securities for compensation. Any form of guidance or recommendation regarding specific securities, classes of securities, the advisability or inadvisability of investing in securities, and even advice about the selection or retention of an investment adviser would be considered investment advice under the Act.

[69] January 13, 2000 letter from CFA Director of Investor Protection Barbara Roper to SEC Secretary Jonathan Katz regarding File No. S7-25-99, Certain Broker-Dealers Deemed Not to be Investment Advisers, http://bit.ly/1Ie0V6U. *See*, in particular, the discussion on pages 7-12.

[70] Peiffer, Joseph C. and Lazaro, Christine, "Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty," Public Investors Arbitration Bar Association Report, March 25, 2015, http://bit.ly/1FW5H7p.

[71] *See* discussion below under Seller's Carve-Out.

[72] Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murray, Secretary, Securities and Exchange Commission, regarding

captures all recommendations that a reasonable investor would view as being intended to address their objectives and needs based on a consideration of their circumstances, and all services that a broker describes and markets as advisory services, such an approach ought to function reasonably well.[73]

3. FINRA guidance offers a sound approach to determining what constitutes a recommendation and, thus, fiduciary investment advice.

In determining exactly what constitutes a recommendation, DOL has looked to guidelines issued by FINRA to help brokers determine whether a particular communication constitutes a recommendation. While the determination of whether a recommendation has been made will always be based on the particular facts and circumstances, we agree with the Department that FINRA guidance provides useful standards and guideposts for distinguishing investment education from investment advice under ERISA. The most directly relevant portion of the FINRA guidance states:

> "An important factor … is whether -- given its content, context and manner of presentation -- a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy. In addition, the more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation. Furthermore, a series of actions that may not constitute recommendations when viewed individually may amount to a recommendation when considered in the aggregate."

This guidance includes four key points that we believe should inform DOL policy with regard to what constitutes a recommendation:

> A Call to Action: Inclusion of some form of call to action is key to distinguishing advice from education. So, for example, general information about asset allocation would not be considered advice; a specific recommendation to invest in a particular fund or set of funds in order to achieve a particular asset allocation would be advice. A recommendation not to act, not to purchase or sell a particular investment, or not to rollover a retirement account balance would also be considered a recommendation under this interpretation.
>
> Particularized for a Specific Client: Unless surrounding circumstances dictated otherwise, a generally favorable statement regarding a particular investment or type of investment would not typically constitute investment advice. A statement that the investment would be a good option in light of the individual's particular circumstances typically would constitute advice. The fact that the adviser might make the same recommendation to more than one client would not contradict the interpretation that the advice was particularized

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Study Regarding Obligations of Brokers, Dealers, and Investment Advisers; Exchange Act Release No. 62577; Investment Advisers Act Release No. 3058, File No. 4-606, Aug. 30, 2010, http://1.usa.gov/1LnVQM1.

[73] CFA July 2013 SEC Comment Letter, at page 8.

if, in each case, the client reasonably believed that the recommendation was directed at them and based on their particular circumstances.

Considering Actions in the Aggregate: In considering whether something constitutes a recommendation, and thus fiduciary investment advice under ERISA, it may be necessary to look at a series of actions to determine whether, taken together, they would reasonably be viewed as including a call to action or being particularized to a specific client.

Reasonable Expectation: An overarching principle of the FINRA guidance is that how the communication is likely to be reasonably perceived by the client is of central importance. If the client would be likely to perceive a communication as a call to action or as particularized to their circumstances, that should be enough to trigger the definition.

There is the added benefit that adopting an approach consistent with FINRA guidance would minimize inconsistencies in regulatory approaches for retirement and non-retirement accounts. Should the SEC eventually live up to its pledge to adopt a fiduciary standard for broker-dealers when they provide personalized investment advice to retail clients, it would presumably be based on a definition of investment advice that closely resembles what DOL has proposed here.

4. *DOL should clarify that the stipulation that the advice must be delivered "pursuant to an agreement, arrangement, or understanding" does not require mutual agreement.*

The rule proposal stipulates two conditions that would determine whether communications that otherwise fit the definition of investment advice would be considered fiduciary investment advice under ERISA. The first comes into play where a financial professional represents that he or she is a fiduciary with respect to the advice. This is simple common sense. A financial professional who communicates to clients that he or she is acting as a fiduciary must be held to that standard. To do otherwise would be grossly misleading, would effectively allow and promote misrepresentations, and would be contrary to principles of estoppel. Where no such representation exists, the rule states that, to be considered fiduciary investment advice, the advice must be provided "pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized to, or that such advice is specifically directed to, the recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA." As noted above, we believe this provision could be misinterpreted to recreate the "mutual agreement" loophole that provides one of the key means by which conflicted advisers evade their fiduciary obligations.

The discussion of the issue in the proposing release strongly suggests that this is not the Department's intention. The release suggests, for example, that this is intended to ensure that, "recommendations made to the general public, or to no one in particular," would not be treated as investment advice and thus to address "concerns that the general circulation of newsletters, television talk show commentary, or remarks in speeches and presentations at financial industry educational conferences would result in the person being treated as a fiduciary." The release goes on to state that, "The parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but they must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for

consideration in making investment decisions." The proposing release provides further clarification that, "advisers could not specifically direct investment recommendations to individual persons, but then deny fiduciary responsibility on the basis that they did not, in fact, consider the advice recipient's individual needs or intend that the recipient base investment decisions on their recommendations. Nor could they continue the practice of advertising advice or counseling that is one-on-one or that a reasonable person would believe would be tailored to their individual needs and then disclaim that the recommendations are fiduciary investment advice in boilerplate language in the advertisement or in the paperwork provided to the client."

While this additional commentary is reassuring, the regulatory language does appear to leave the door open to evasion. Use of the term "agreement" by definition suggests some degree of mutuality. And, while the release makes clear that advisers could not continue their current practice of using boilerplate disclosures to disclaim fiduciary responsibility, it leaves open the possibility that some form of non-boilerplate disclosure might suffice. We strongly urge the Department to remove any ambiguity on this point and clearly state that, for advice to be considered fiduciary investment advice under ERISA, it is enough that a reasonable person under the same circumstances would perceive the advice to be particularized or specifically directed to them for consideration in making investment or management decisions.

5. *The Department should clarify that firms can market their services without necessarily triggering the definition of fiduciary investment advice.*

Some commenters have raised the concern that firms would not be able to market their services without triggering the definition of fiduciary investment advice. While we believe these concerns have been exaggerated, there is enough ambiguity on the point to justify a clarification. Specifically, the Department should make clear that basic marketing of advisory services does not constitute fiduciary investment advice unless it also includes recommendation of a specific course of action regarding the advisability of "acquiring, holding, disposing of or exchanging securities or other property" or a recommendation regarding the management of securities or other properties. This potential to combine marketing and advice is most likely to arise in the context of a rollover recommendation, where the recommendation to hire the adviser is contingent on rolling money out of a 401(k) and under their management. In such circumstances, the rule should make clear that any recommendations included in marketing messages regarding whether to rollover assets or how to invest such assets would still be considered fiduciary investment advice.

B. CFA Generally Supports the Carve-Outs from the Definition of Fiduciary Advice Provided in the Proposed Rule.

The rule proposal provides several carve-outs from the definition of fiduciary investment advice. The most significant of these from the point of view of individual retirement savers are the education carve-out and the seller's carve-out, both of which have been significantly improved since the 2010 proposal, and the platform provider carve-out.

1. The education carve-out appropriately preserves financial firms' ability to offer bona fide *education while ensuring that specific investment recommendations are classified as advice.*

The Department has long recognized the distinction between general education and specific investment advice and both maintains and reinforces that distinction in the current rule proposal. As is the case under current rules, the proposal includes an explicit carve-out from the definition of fiduciary investment advice for *bona fide* retirement investor education. By incorporating and largely maintaining the education carve-out framework that the Department issued in 1996 in Interpretive Bulletin (IB 96-1), the proposal ensures that firms and advisers will be able to provide significant amounts of information and materials to retirement investors without being subject to a fiduciary duty. At the same time, the Department narrows the current policy in one important way: it classes as advice online interactive tools and asset allocation models that direct the user to specific investments. We agree that such tools are appropriately regulated as advice. At the same time, however, we believe adjustments can and should be made to preserve the benefits of such tools while protecting against the risks.

According to the terms of the education carve-out, the definition of fiduciary investment advice will not be triggered as long as an adviser or firm provides to a retirement saver general educational information and materials and not a specific recommendation or specific alternatives upon which to act. Educational information and materials subject to the carve-out are divided into four broad categories: (i) plan information; (ii) general financial, investment and retirement information; (ii) asset allocation models; and (iv) interactive investment materials. The proposed regulation also states that there may be other examples of information, materials, and education services which, if furnished, would not constitute investment advice or recommendations within the meaning of the proposed rule. Thus, the types of information that may constitute permissible investor education are very broad in scope, reflecting the DOL's recognition of the importance of providing retirement savers with materials that can help them make better informed retirement decisions.

The proposal further makes clear that the education carve-out is available irrespective of who provides the information, the frequency with which the information is shared, the form in which the information and materials are provided, or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of investment or retirement information and materials, or the type of plan or IRA involved. As a result, the focus of the carve-out is appropriately on the *content* of the information provided rather than the *form* in which it is presented or its method of delivery.

In clarifying the line between *bona fide* education and investment advice, the DOL has offered an important change from IB 96-1 with respect to the treatment of certain website tools used by financial firms to help savers identify appropriate funds. Many financial firms offer website tools that ask retirement investors to provide specific personal information, including how much money they want to invest, their investment goals, time horizon, and risk tolerance. Based on the personal information that the retirement investor inputs, the saver is provided a "model portfolio," sometimes also referred to as an "Action Plan." Such "model portfolios" or "Action Plans" include various percentages of different asset categories with specific investment

illustrations populating each of the asset categories. For example, an asset allocation model may recommend that an investor hold 15 percent of her portfolio in an international value fund, and populate the international value category with JPMorgan International Value Fund to illustrate how the investor could implement that position. The investor is then presented with the option of hitting an "Act Now" button to implement that "model portfolio" or "Action Plan."

Current policy under IB 96-1 treats these tools as education rather than advice, so long as the results are accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available and identifying where information on those investment alternatives can be obtained. However, the DOL has expressed the concern that, even when accompanied by a statement that other investment alternatives are available, the act of identifying specific investment alternatives functions as a tailored, individualized investment recommendation. Moreover, without adequate protections against potential abuse, these tools could be used to effectively steer users to particular investments based on criteria other than the best interests of the retirement saver. The GAO identified this as a problem in a 2011 report, stating: "For example, although investment education is defined as generalized investment information, providers may highlight their own funds as examples of investments available within asset classes even though they may have a financial interest in the funds. According to industry experts, participants perceive education as investment advice. Thus, participants may not understand that the provider is not a fiduciary adviser required to act solely in participants' best interests."[74]

We agree with the assessment of both the DOL and the GAO that an investor would reasonably view these types of tools, not as general education, but as providing them with a recommendation that is specifically directed at them, that is based on their personal circumstances, and that is clearly designed to be acted upon. In other words, these tools clearly meet the definition of fiduciary investment advice the department has proposed. We also share the DOL's concern that asset allocation models and interactive investment materials could be used to steer savers to particular investments without regard to the best interests of the saver. Some firms design their interactive tools with care, based on objective criteria and rigorous methodologies. As long as the tools are categorized as education, however, there is no regulatory mechanism available to ensure that this is the case. Instead, a firm could design its model to favor certain investment options whose sale ultimately benefits the firm rather than the investor. This concern is especially pronounced in the retail context, where a firm could steer retirement investors to proprietary products that enhance the compensation paid to the firm or to third-party products that provide the highest revenue-sharing payments to the firm.

Some industry participants have urged the DOL to withdraw its proposed change to IB 96-1, arguing that the tools they offer can be useful to retirement investors and the rules would inhibit their use. One problem is that, because they constitute online-only advice, the tools do not qualify for the best interest contract exemption. While we agree that these tools, if properly designed and with appropriate safeguards, can in fact be useful, we disagree with industry's proposed solution. Simply maintaining the status quo does not adequately address the very real threat that these tools could be used in ways that are not in users' best interests. This is of

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[74] Government Accountability Office, *401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, January 2011, http://1.usa.gov/1gJXDy2.

particular concern if they are used in conjunction with rollover recommendations or advice to IRA investors more generally. That said, we do encourage DOL to adopt an approach that preserves the benefits of these tools while protecting against potential abuses.

In developing an approach to achieve that goal, we think it is appropriate to distinguish between the plan and IRA contexts. In the plan context, which is the only context in which IB 96-1 currently applies, a plan fiduciary has already selected the menu of investment options for the plan participants to invest in. That selection process must be made according to a duty of prudence and loyalty. As a result, any steering by an asset allocation model would be contained within, and therefore constrained by, an already approved menu of investment options. And, as a practical matter, because most plans do not have a significant number of investment options for each asset category, an asset allocation models' ability to steer retirement savers to a certain fund would likely be further constrained, particularly in the case when only one fund meets each asset category. The exception is where the plan includes a brokerage menu, where the plan participant has access to a broader universe of investment options. That exception aside, the protections that exist within the plan context decrease both the probability and the scope of the harm that asset allocation models could cause retirement savers.

However, no analogous protections for retirement investors exist in the IRA context, including with regard to rollovers. Because there is no initial narrowing of investment options by a fiduciary, asset allocation models would be free to present illustrations using whatever investment options benefit the firm designing and implementing the model, regardless of whether those options are in the investor's interests. Should that information qualify as education, it would be removed entirely from any fiduciary protections. Doing so would recreate the very problem that the DOL is attempting to solve -- allowing firms to make recommendations that are reasonably viewed by recipients as investment advice but which aren't subject to appropriate protections. Even cautionary disclosures about the availability of other investment alternatives would be unlikely to mitigate the harm that retirement investors would experience if asset allocation models were allowed to identify specific investment alternatives without being subject to appropriate safeguards.

We believe the rule can and should be adjusted to preserve the benefits of these tools while constraining the risks. Recognizing the important distinctions between the plan and retail contexts, one possibility would be to retain IB 96-1 in its current form for use exclusively in the plan context and only where there is a limited menu of investment options (i.e., not in combination with a brokerage window). A different approach would need to be adopted for the retail context. This could include, for example, allowing such tools to be offered in compliance with the best interest contract exemption.

We understand, however, that the DOL has expressed a preference for treating equally the information that's provided in the plan and retail contexts. To accommodate this preference, one option would be to allow asset allocation models to identity specific investment alternatives, but only if all available alternatives within an asset class under the plan or IRA are listed and none is preferenced. If this approach were adopted, investors would be unlikely to view the tool's response as a tailored, individualized investment recommendation for action. On the other

hand, the tools would arguably lose much of their value, at least in those circumstances where dozens of funds, or more, might be listed in each asset class.

A different, and in our view better, approach would be to adapt the requirements of the Pension Protection Act regarding online tools to fit this purpose. The PPA appears to include the essential requirements to ensure that recommendations are based on appropriate criteria. For this approach to work, the tools should be permitted to be used either as online only tools or in conjunction with advice from an adviser. We encourage the DOL to consider whether this or a similar approach could be adopted that would preserve the benefits associated with these tools while significantly reducing the risk that they would be misused to steer retirement savers into less than optimal investment options.

2. *We commend the DOL for proposing a narrow seller's carve-out that applies only in the large plan context, and we urge the DOL to maintain this framework in a final rule.*

The rule proposal includes an explicit carve-out from the definition of fiduciary investment advice that allows a financial adviser to make sales recommendations to a fiduciary of a large employer-sponsored plan without being subject to a fiduciary duty. There are two alternative ways in which an adviser can claim relief under the proposed seller's carve-out, one for plans with 100 or more participants and one for plans with at least $100 million in assets.

- Under the first alternative, an adviser can provide a sales recommendation to a plan fiduciary whose plan has 100 or more participants only after the plan fiduciary has provided a written representation that he or she will not rely on the adviser to act in the plan's best interests, provide impartial investment advice, or give advice in a fiduciary capacity. In addition, the adviser must inform the plan fiduciary of the nature of his or her financial interests in the transaction and must know or reasonably believe that the plan fiduciary has sufficient expertise to evaluate the transaction. These conditions are designed to ensure that the plan participants' interests are ultimately protected.

- Under the second alternative, an adviser can provide a sales recommendation to a plan fiduciary whose plan has at least $100 million in assets without obtaining the written representation required under the first alternative. However, the adviser must still comply with the other reasonable conditions, discussed above, that are designed to ensure that the plan participants' interests are ultimately protected.

The DOL's stated purpose for this carve-out is to avoid triggering fiduciary obligations on sales pitches that are part of arm's length transactions where neither side assumes or expects that the financial adviser is acting as an impartial trusted adviser, but where the seller is making representations about the value and benefits of proposed deals that might otherwise trigger the definition of fiduciary investment advice. Large plan fiduciaries who meet the conditions of the carve-out are typically financial professionals whose primary responsibilities are to implement and run retirement plans for their employees and who therefore, at least in theory, are likely to have sufficient financial expertise and sophistication to protect their own interests. Because of their heightened expertise and sophistication, they are likely to understand the nature and costs of

sales-related conflicts of interest. Further, they are likely to be able to effectively identify and distinguish sales pitches from advice, and protect themselves and plan participants from the types of harm that can result when sales pitches are perceived and treated as advice. They are also likely to be able to use different financial service providers' sales pitches to the plan's benefit, forcing providers to compete for their business. Finally, they are likely to be able to independently assess the quality of the sales recommendations they receive and make a final judgment that benefits the plan participants.

Because retail investors and small plan fiduciaries typically do not relate to financial professionals in ways that fit the "arm's length" characteristics that the seller's carve-out is designed to achieve, the carve-out is unavailable for them under the proposed rule. Sales recommendations to retail investors and small plan sponsors are often presented as impartial advice that they should trust, and retail investors and small plan sponsors often rely on those recommendations as advice that they should follow. And, because most retail investors and small plan sponsors are not financial experts, they are likely to be unaware of the magnitude and impact of sales-related conflicts of interest and unable to protect themselves against those conflicts. They are also by and large unable to effectively assess the quality of the recommendations they receive and take action based on what is in their best interests. Retail investors may be particularly at risk because they lack the protection of having a plan fiduciary select an initial menu of investment options from which they can invest.

We wholeheartedly commend the DOL for taking this approach to the seller's carve-out, which is a significant improvement over the approach proposed by the DOL proposed in 2010. The 2010 proposal contained an overly broad seller's exception that would have allowed advisers to claim the exception, and escape their fiduciary obligations, so long as they disclosed that they were acting in a sales relationship, that their interests were "adverse" to those of the retirement investor, and that their recommendations were not intended to be impartial. W. Scott Simon, an ERISA fiduciary expert, described the 2010 seller's exception as the "fiduciary exemption that swallows the rule" by allowing current fiduciaries to "absolve" themselves of fiduciary obligations even while making personalized recommendations."[75] Mercer Bullard, the MDLA Distinguished Lecturer and Professor of Law at the University of Mississippi Law School, raised similar concerns when he wrote: "The basis for finding a fiduciary duty is a relationship of dependence, whether through trust, informational disadvantage, relative incapacity, or some combination thereof that results in potential overreliance on the fiduciary's advice. Simply knowing that a fiduciary has a conflict of interest changes none of the factors that make fiduciary standards necessary. It may even exacerbate the client's overreliance on the conflicted fiduciary's advice if the candid admission of the conflict engenders even greater, but still misplaced trust."[76] The effective result of the 2010 proposed seller's exception would have been to create in the retirement investment advice market the same problem that Congress intended to fix in the securities market when it enacted Section 913 of the Dodd-Frank Act, which authorizes the SEC to impose a fiduciary duty on brokers-dealers when they provide personalized investment advice to retail investors.

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[75] W. Scott Simon, "The Fiduciary Exemption That Swallows the Rule," MorningstarAdvisor, May 5, 2011, http://bit.ly/1TLZPmX.

[76] Mercer Bullard, "DOL's Fiduciary Proposal Misses the Mark," MorningstarAdvisor, June 14, 2011, http://bit.ly/1le1NZh.

Extensive evidence demonstrates that retail investors do not understand either the distinction between sales and advice or the differences between various types of financial professionals, and that disclosure, even when combined with education, is ineffective in eliminating this confusion.[77] This is understandable since the sellers routinely call themselves "financial advisors" and "financial consultants," describe their services as retirement planning, and market those services as if advice were the primary service being offered. While some object to this argument as condescending or paternalistic, the supporting evidence is overwhelming.

In 2005, for example, the SEC commissioned Siegle & Gale, LLC and Gelb Consulting Group, Inc. to conduct focus group testing "to understand how investors differentiate the roles, legal obligations, and compensation among … brokers, financial advisors/financial consultants, investment advisers, and financial planners." The purpose of the study was "to provide feedback regarding a proposed disclosure statement developed by the SEC."[78] That study found that investors:

- were generally "unclear about the distinctions" among the various titles;
- were generally unfamiliar with the term investment adviser; and
- assumed that financial advisors and financial consultants (titles typically adopted by brokers) provided "a broader scope of long-term planning advice" than brokers.

Study participants also provided feedback on a proposed disclosure intended to alert investors to differences between fee-based brokerage accounts and advisory accounts. In general, according to the report on focus group findings, "investors found the statement communicates that differences might exist, but did not do enough to explain those distinctions … As a result, investors were confused as to the differences between accounts and the implications of those differences to their investment choices."

Unable to arrive at an approach to disclosure that was likely to be effective, and recognizing "that any future regulatory reform would have to be based on a clearer understanding of the industry's complexities," the SEC commissioned the RAND Corporation to conduct a study that could provide the basis for future rulemaking.[79] Among the wide-ranging study's key findings: the once-clear functional distinctions between brokers and investment advisers had become blurred, investors found it difficult to distinguish between brokers and investment advisers, and they tended to view financial advisors and financial consultants "as being more similar to investment advisers than to brokers in terms of services and duties." Even when plain English explanations were provided, focus-group participants struggled to understand the differences between a fiduciary duty and suitability standard and "expressed doubt that the

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[77] *See, e.g.*, Hung, Angela A., et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, Rand Corporation, Sponsored by the United States Securities and Exchange Commission, January 2008, http://1.usa.gov/1nePF0L.

[78] Siegel & Gale, LLC and Gelb Consulting Group, Inc., Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures, Report to the Securities and Exchange Commission, March 10, 2005, http://1.usa.gov/1MkdujW.

[79] *Id.*

standards differ in practice." Moreover, they expected brokers and advisers alike to act in the investor's best interest.

A 2010 study commissioned by CFA, AARP, North American Securities Administrators Association, CFP Board of Standards and the Investment Adviser Association and conducted by ORC/Infogroup found similar results.[80] For example, 65 percent of 18-34 year olds and 57 percent of households with $100,000 or more in household income mistakenly thought that "insurance agents" have a fiduciary duty to their clients; 70 percent of 45-54 year olds and 62 percent of college graduates were incorrect in thinking that stockbrokers are held to a fiduciary duty; 76 percent of investors were wrong in believing that "financial advisors" are held to a fiduciary duty; 34 percent, including 41 percent of 18-34 year olds and 45 percent of African Americans, incorrectly thought that financial advice is the "primary service" offered by stockbrokers; and another 27 percent believed that "advice and assistance in conducting transactions are equally important services offered by brokers." Only 29 percent understood that the primary service of stockbrokers is to "buy and sell stocks, bonds, mutual funds, and other investment products on behalf of their clients, and they give only limited advice that is directly related to those transactions."

Some attribute investors' lack of understanding of these key concepts to their failure to make good use of the disclosures provided to them. And, it is true that many if not most investors also are likely to ignore disclosures. For example, the RIA cites the 2008 Rand Study's interviews of representatives of brokerage firms who reported efforts to clearly disclose conflicts. Several acknowledged that "investors rarely read these disclosures…[F]or many investors, the fact that they were given disclosures was seen as meaningless."[81] However, this overly simplistic explanation is undercut by the RAND study findings that investors struggled to understand differences in the standard of care even after receiving a plain English explanation and that investors were typically unable to tell whether their own financial professional was a broker or an adviser even after reading brief fact sheets explaining the differences. This is strong evidence that, regardless of what disclosures are provided, retail investors are ill-equipped to make informed investment decisions by themselves, including the decision of whom to rely on for investment advice.

Moreover, a 2012 SEC study of disclosure effectiveness included a survey by Siegel & Gale that tested both investors' understanding and use of disclosures.[82] Siegel & Gale found, for example, that: among online survey respondents who recalled receiving a conflict of interest disclosure, just over half reported that they fully understood the potential impact on their advisory relationship and only a little over half of respondents who said they understood the conflicts of interest fully or even somewhat actually took action to protect their interests. There was also confusion about how different advisers charge and the unique conflicts that accompany different advisers' compensation models. When investors' ability to comprehend actual

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[80] U.S. Investors & The Fiduciary Standard: A National Opinion Survey, ORC/Infogroup, September 15, 2010, http://bit.ly/1fMAERB.

[81] *Id*; *See also* Haziza, Mor and Kalay, Avner, Broker Rebates and Investor Sophistication, Sepetermber 2014, http://bit.ly/1LmYXDG.

[82] Siegel & Gale, LLC, *Investor Research Report*, Submitted to the Securities and Exchange Commission on July 26, 2012, http://1.usa.gov/1MfBbss.

disclosures was tested, the results were even more troubling. For example, having reviewed a sample disclosure that begins as follows, "In addition to sales loads and 12b-1 fees described in the prospectus, we receive other compensation...," just over half (54.8 percent) correctly answered a question about whether the firm gets compensation other than sales loads and 12b-1 fees. After reviewing a sample chart providing information on additional payments the firm receives from mutual fund companies, only 31.8 percent indicated they definitely knew what the term "annual asset fees" means, and another 46.2 percent indicated they thought they knew what it means. But survey respondents were generally unable to determine the significance of the information provided.

The DOL discusses at length in its RIA the extensive academic and empirical evidence that strongly suggests that disclosure alone is ineffective at mitigating conflicts in financial advice. This includes comprehensive research that retail investors are incapable of adequately understanding the implications of disclosed conflicts and factoring that understanding into their choice of adviser and investments.[83] It also cites to evidence showing that conflict disclosures can actually have a harmful impact on investors. Behavioral economists have found for example that, even where investors are able to pay attention to and understand disclosures regarding adviser conflicts, they still may react to disclosures in ways that "backfire," thus exacerbating the harms that can result from these conflicts.[84] For example, they might interpret conflict disclosures as a sign of honesty or high professional standing, or feel socially constrained from questioning their adviser's integrity or threatening their livelihood. At the same time, their adviser may feel "morally licensed" to pursue his or her own interests over the customers' interests after having warned them of the conflicts. One legal academic who has surveyed the literature of broker obligations, conflicts, and disclosure concludes that, "disclosure alone is a frail tool with which to attack the many ills that arise from blatant conflicts of interest in the financial industry."[85]

Based on the extensive academic and empirical evidence, the DOL has rightly concluded that a rule that relies on disclosure alone to mitigate adviser conflicts, which is what the seller's

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[83] *See, e.g.*, Hung, Angela et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, Rand Corporation, Sponsored by the United States Securities and Exchange Commission, January 2008, http://1.usa.gov/1nePF0L; U.S. Investors & The Fiduciary Standard: A National Opinion Survey, ORC/Infogroup, September 15, 2010, http://bit.ly/1fMAERB. *See also*, Prentice, Robert A., Moral Equilibrium: Stock Brokers and the Limits of Disclosures, Wisconsin Law Review 2011, http://bit.ly/1MD3JKL;
Chater, Nick et al., Consumer Decision-Making in Retail Investment Services: A Behavioral Economics Perspective, Decision Technology Ltd, November 2010, http://bit.ly/1MfFaVW; Robertson, Christopher Tarver, Biased Advice, Emory Law Journal, April 12, 2011, http://bit.ly/1MfFhkC; Burke, Jeremy et al., Impacts of Conflicts of Interest in the Financial Services Industry, Rand Corporation, February 2015, http://bit.ly/1MfFjJ9. These are just a few of the many studies showing disclosure, even when combined with education, is ineffective at eliminating investor confusion and adequately curing the harms that result from conflicts of interest.

[84] *See, e.g.*, Cain, Daylian, Loewenstein, George, and Sah, Sunita, The Limits of Transparence: Pitfalls and Potential of Disclosing Conflicts of Interest, http://bit.ly/1gJYyP6; Cain, Loewenstein and Moore, Don, The Dirt on Coming Clean, http://bit.ly/1gJYBu8; *See also* Chater, supra; Francesca, Gino, Brooks, Alison W., and Schweitzer, Maurice E., "Anxiety, Advice, and the Ability to Discern: Feeling Anxious Motivates Individuals to Seek and Use Advice," Journal of Personality and Social Psychology, Vol. 102, No. 3, March 2012, pp. 497-512; Nicholas, Dopuch, King, Ronald R., and Schwartz, Rachel, "Independence in Appearance and in Fact: An Experimental Investigation," Contemporary Accounting Research, Vol. 20, No. 1, 2003, pp. 79-114.

[85] Prentice, Robert A., Moral Equilibrium: Stock Brokers and the Limits of Disclosures, Wisconsin Law Review 2011, http://bit.ly/1MD3JKL.

carve-out does, would be ineffective, would yield little or no investor gains, and would therefore fail to justify the compliance cost associated with requiring increased disclosure. We agree that the research is clear: that investors do not understand the different titles that various financial professionals use, various financial professionals' respective roles and legal obligations, or the nature and implications of the different relationships they might have with various financial professions, including the potential conflicts of interest that exist in those relationships and that disclosure fails to remedy any of these gaps in knowledge. With these significant gaps in knowledge that cannot be narrowed, most retail investors are unlikely to have the financial sophistication necessary to check the quality of advice, detect adviser misbehavior, and adequately protect themselves from conflicts. Absent a reasonable basis for believing that investors will be able to identify and protect themselves from conflicted advice, a broad seller's exemption in the retail context simply cannot be justified.

Similar to retail investors, small plan fiduciaries by and large lack the financial expertise and sophistication necessary to fully understand sales-related conflicts of interest and protect themselves and their employees' retirement savings from those conflicts, rendering them ill-suited for the seller's carve-out as well. The typical small business owner is focused on surviving and being profitable. While many small business owners want to offer their employees a high quality retirement plan, they may not have the time or expertise to properly evaluate their various investment options. As a result, they often rely on what they reasonably believe to be objective, trustworthy advice from financial professionals. There are many firms in the market today that offer advice to small business owners under a fiduciary standard. But in some cases what is presented as advice is actually a sales pitch. Indeed, by the industry's own admission, the small plan market is one in which "retirement plans are sold not bought."[86]

Industry surveys and advertisements acknowledge the fact that small plan sponsors are confused about setting up and running their plans. They emphasize that they are there to help navigate the many complicated decisions small employers have to make. For example, a 2012 survey by Fidelity found that 53 percent of the nation's nearly six million small businesses may not have optimal retirement plans that best fit their needs.[87] In addition, Fidelity found that "many small business owners are struggling to understand the features and benefits of their current retirement plans." The survey of more than 500 small business owners gauged the respondents' understanding of SEP-IRAs, SIMPLE-IRAs and Self-Employed 401(k) plans, and the results highlight the education gap that many small business owners face with regard to their current plans. When asked a series of basic questions about their retirement plan features and benefits, respondents on average answered just 66 percent correctly.

In response to its findings, Fidelity published a Viewpoints article outlining the basic differences in the various plans in order to educate small business owners about their options.[88] In the press release announcing the article, Ken Hevert, vice president of Fidelity Investments,

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[86] *See, e.g.*, Elaine Floyd, "A Quick Guide to Retirement Plans for Small Business Owners," Parks Capital, 2012, http://bit.ly/1Ly6U7H. *See also* Five Reasons Small Business Owners Should Establish a New 401(k) Plan, PayChex.com, August 12, 2013, http://bit.ly/1fYdeKd; Financial advisor guide to selling small business plans, American Funds, June 2015, http://bit.ly/1LybbrV

[87] Press Release, "Fidelity® Survey Finds More Than Half of Nation's Six Million Small Businesses May Not Have Optimal Retirement Plans," February 22, 2012, http://reut.rs/1Kgqcg9.

[88] Retirement plans for small businesses, Fidelity Viewpoints, June 3, 2015, http://bit.ly/1RJz1pR.

highlighted the advisory nature of Fidelity's services: "To ensure small business owners are in the best plan, Fidelity works closely with them to evaluate their specific retirement savings goals through one-on-one guidance with our investment professionals and educational content online." In the article itself, Fidelity offered its services to small business owners looking for help, stating: "But what type of retirement plan is the right fit for your business? There are several types to choose from and the options can be confusing." Hevert was quoted in the article as well, indicating that small plan sponsors don't understand their options, can't independently determine what option is best for their unique circumstances, and need help in making those decisions. "Many small-business owners say they want to set up a 401(k) plan because that is the plan they are most familiar with...However, after reviewing their situation, small business owners often conclude that perhaps another plan type, such as a SEP IRA or a Self-Employed 401(k), may be more appropriate," he said. At the bottom of both the release and the article, Fidelity included the standard disclaimer in tiny font: "Although consultations are one on one, guidance provided by Fidelity is educational in nature, is not individualized, and is not intended to serve as the primary or sole basis for your investment or tax-planning decisions."

Similarly, Raymond James advertises on its website that, "For many business owners, the question is not 'Should I implement a retirement plan?' Rather, it is 'Which plan is right for my business?' The choices are many: SEP, profit sharing, 401(k), SIMPLE IRA and defined benefit, to name a few. This web page is designed to resolve some of the confusion caused by the wide range of choices available to business owners like you....What is the right retirement plan for your business? The retirement plans discussed here illustrate that there are a wide variety of choices available to you as a business owner. With help from your financial advisor – a professional committed to your needs – you can choose the plan that best suits your business retirement plan needs and objectives. Of course, we cannot offer legal advice to clients. Before implementing any plan, you should consult with your tax and/or legal advisors."[89]

In both cases described above, the disclaimers are directly contradicted by an overarching message that the financial adviser is there to help the business owner cut through the confusion and identify the best option for them. A small business person who doesn't even know his or her basic options when setting up a plan is highly unlikely to understand the implications of such a disclaimer. After all, everything else in the presentation is designed to send exactly the opposite message -- that the information is individualized and is designed to be acted upon. They are just as unlikely, in our view, to understand and appreciate disclosures relating to sales-related conflicts.

A 2012 GAO report provides further support for the notion that small plan fiduciaries lack the expertise and sophistication necessary to protect against advisers' conflicts of interest.[90] According to its findings, "Small employers and other stakeholders said that plan options and administration requirements are frequently complex and burdensome and discourage some small employers from sponsoring a plan. For example, some small employers and retirement experts said that the number of plan types and features make it difficult for small employers to compare and choose plans. Representatives of a plan service provider said that too many plan options

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[89] Choosing the right retirement plan for your business, Raymond James, http://bit.ly/1IealtU.

[90] Government Accountability Office, Private Pensions: Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship, March 2012, http://1.usa.gov/1gK1efq.

overwhelmed small employers, making it more difficult for them to choose a plan and, ultimately, less likely that they will sponsor one."[91]

The report also found that small employers have trouble understanding and carrying out their fiduciary responsibilities, and often rely on professionals for advice about what to do. According to the report, "A number of stakeholders indicated that understanding and carrying out a sponsor's fiduciary responsibilities with respect to their qualified retirement plans presents significant challenges to some small employers.... Some small employer sponsors found the selection of investment fund options for their plans particularly challenging. A small employer with a 401(k) plan described the difficulties of selecting appropriate investment options, with an appropriate balance of risk, for a workforce that includes younger and older workers. A number of small business advocates and retirement experts said that not all small employers have an adequate understanding of their fiduciary duties and are not always aware of all their responsibilities under the law. For example, a retirement expert said that small employers that do not consult with plan professionals often lack the time and expertise to understand complicated fiduciary rules under ERISA. One service provider explained that some small employers mistakenly believe that all fiduciary responsibilities and liabilities are transferred to a service provider when they are hired. Another expert noted that some small employers have an exaggerated sense of the liabilities that being a fiduciary carries, and may avoid sponsoring a plan out of fear of being sued by their employees."[92]

In the report's recommendations section, stakeholders said more education and outreach are needed to increase awareness of plan options and requirements. Officials of a service provider to small businesses even stated that, "because clients are generally not aware of the retirement plan options available to them, the federal government should provide more education and outreach to improve awareness of the plan types available and rules that apply to each."[93] Our experience suggests, however, that education alone is unlikely to be effective. A far more effective solution is to ensure that the advice small business owners receive with regard to their plans is delivered under a fiduciary duty and consistent with the best interests of plan participants. That is best achieved through the approach adopted by DOL in its revised rule proposal of limiting the seller's exemption to large plans. Again, we appreciate the DOL's willingness to reconsider and revise the applicability of a seller's carve-out, and we strongly urge the agency to maintain this approach in a final rule.

3. The platform provider carve-out should be strengthened to better protect against the harmful impact of conflicted payments.

The rule provides a broad carve-out from the definition of fiduciary investment advice for service providers, such as recordkeepers and third-party administrators, who offer a "platform" or selection of investment vehicles to participant-directed individual account plans. Under the terms of the carve-out, the plan fiduciaries would be required to choose the specific investment alternatives that will be made available to participants for investing their individual accounts. Where that is the case, service providers would not be deemed to be acting as investment advice

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[91] *Id.*
[92] *Id.*
[93] *Id.*

fiduciaries by virtue of marketing or making available such investment vehicles, without regard to the individualized needs of the plan or its participants and beneficiaries, as long as they disclose in writing that they are not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. We believe this carve-out does not adequately protect against the harmful impact of conflicted payments on the selection of platform menu options.

The selection of plan investment menus is vitally important to plan participants. This determines whether they will have high quality, low cost options available to choose from when they participate in workplace retirement plans. And that in turn can have a dramatic impact on the size of retirement nest egg they are able to amass over a career of workplace retirement savings. But research has shown that the payments platform providers receive from mutual fund companies and other investment product sponsors, and incentives to promote their proprietary products, affect the choices they make regarding selection of investment options for their platforms and can do so in ways that is harmful to plan participants.

A 2011 GAO report raised significant concerns regarding the potential harmful impact of third-party payments to plan service providers on selection of investment options by those service providers. It states: "Several industry experts we spoke with cited third-party payments, also known as revenue sharing, as a potential conflict of interest for service providers involved in the fund selection process for a 401(k) plan. ... According to industry experts, revenue sharing is a widespread practice among 401(k) service providers. As we have previously reported, revenue-sharing payments can be used to offset expenses the plan has agreed to pay and thus be cost-neutral to the plan. However, ... revenue sharing may, depending on the circumstances, also create a conflict of interest if it is not structured to be cost-neutral to the plan and may result in increased compensation to service providers. Industry experts we spoke with explained that this situation creates an incentive for the service provider to suggest funds with higher revenue-sharing payments. Because of these conflicts of interest, the service provider may suggest funds that have poorer performance or higher costs for participants compared with other available funds."[94] The report noted, moreover, that, "The amount of revenue-sharing payments can vary considerably, both across investment funds and within a fund through different share classes. Documentation we obtained showed revenue-sharing payments from hundreds of share classes of different investment funds that ranged from 5 to 125 basis points (bps). Given this variation, EBSA field investigators told us that a service provider might only recommend or include fund share classes that pay higher revenue sharing and exclude other fund share classes that pay lower or no revenue sharing."

A Pension Research Council Working Paper raises similar concerns with regard to the harmful impact of conflicts that arise when mutual fund families acting as service providers in 401(k) plans display favoritism toward their own affiliated funds.[95] The study finds that "affiliated mutual funds are less likely to be removed from and more likely to be added to a 401(k) menu. In addition, fund deletions and additions are less sensitive to prior performance for

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[94] GAO, *401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, January 28, 2011, http://1.usa.gov/1gJXDy2.

[95] Pool, Veronika K., Sialm, Clemens, and Stefanescu, Irina. "It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plans," Pension Research Council Working Paper, May 2015, http://bit.ly/1MfLygb.

affiliated than for unaffiliated funds." It finds "no evidence that plan participants undo this affiliation bias through their investment choices." On the contrary, the study finds that "the reluctance to remove poorly-performing affiliated funds from the menu generates a significant subsequent negative abnormal return for participants investing in those funds."

These are precisely the sorts of conflicts of interest that this rule is intended to protect against. Moreover, the same concerns that apply to small plan fiduciaries' ability to assess conflicts in the context of a seller's exemption apply equally with regard to services from platform providers. And yet, the platform provider carve-out does not even require that these conflicts be clearly disclosed, let alone that they be appropriately constrained. We urge the Department to revise the conditions of the carve-out to address these shortcomings. Ideally, any third-party payments received by service providers relying on the platform carve-out should have to be structured to be cost neutral to the plan. At a minimum, the selection of investment options should have to be based on neutral criteria and those criteria should have to be disclosed to plan fiduciaries, and any financial incentives to favor certain investment products in the selection of menu options should have to be clearly disclosed in a consistent manner. We believe these changes are necessary and appropriate to ensure that plan participants have access to the highest quality investment options.

III. Best Interest Contract Exemption

By closing loopholes in the definition of fiduciary investment advice, the proposed conflict of interest rule expands the population of fiduciary advisers to include many whose compensation practices do not comport with ERISA's strict prohibition on conflicted payments. The Best Interest Contract Exemption (BICE) is designed to ensure that financial advisers can comply with their fiduciary obligations under ERISA regardless of their business model. It achieves this in part by borrowing from securities law principles, in particular replacing ERISA's "solely in the interest" standard with a "best interest" standard that relies on mitigation rather than elimination of conflicts. The result is a principles-based rule that is both tough and flexible.

In assessing the rule proposal, we have identified certain fundamental features of the BICE that are in our view critical to its effectiveness. Chief among them are the following:

- The protections afforded by the rule must be legally enforceable.
- They must include a fiduciary duty to act with prudence and loyalty and in the best interests of the customer.
- That obligation must be backed by meaningful restrictions on industry practices that encourage recommendations that are not in the best interest of the customer.
- Compensation must be limited to what is reasonable.

Those features must be included in the DOL's final rule for the agency to make a proper finding under section 408(a) of ERISA that this exemption is in the interests of plans and their participants and beneficiaries and IRA owners and protective of the rights of participants and

beneficiaries of plans and IRA owners. While there are areas where we believe adjustments can and should be made, we believe the proposed BICE meets this standard. Moreover, additional provisions of the BICE – such as the enhanced disclosure requirements and additional protections for sales from a limited menu of products – reinforce these central components in ways that significantly strengthen the rule.

A. The Protections Afforded by the Rule Must be Legally Enforceable.

If the rule is to achieve its goal of providing meaningful new protections to retirement savers, it must include a mechanism by which firms and their advisers can be held legally accountable for the investment recommendations that they make to retirement investors in both the employee benefit plan and IRA contexts. It is especially critical to create legal enforceability in the IRA context, because ERISA's general fiduciary obligations of prudence and loyalty do not currently apply in the IRA context. While the Code's prohibited transaction rules do apply in the IRA context, neither IRA owners nor the Secretary of Labor can bring suit to enforce those prohibited transaction rules. And the Internal Revenue Service, which does have enforcement authority, does not have the resources to provide effective enforcement of the rule.

The BICE achieves this legal enforceability by requiring that the adviser and the adviser's firm enter into a written contract with the retirement saver prior to providing fiduciary investment advice. This written contract must affirmatively state that the adviser and financial institution are fiduciaries under ERISA or the Code or both with respect to any investment advice to the retirement investor, that the adviser and financial institution affirmatively agree to, and comply with, impartial conduct standards, and that the adviser and financial institution make certain warranties. The contract must also contain certain disclosures, discussed below, and not contain any prohibited contractual provisions.

CFA strongly supports the contract requirement of the BICE, which is crucial to providing legal enforceability, particularly in the IRA market. We recognize, however, that financial firms have raised strong objections to the contract requirement, arguing that, at least as currently drafted, the requirement is unworkable. Though some of these concerns appear to be greatly exaggerated, others appear to be based on at least a grain of truth. We are therefore open to considering alternative approaches as long as the end result is a legally binding obligation that includes the key components of the BICE.

One concern raised by industry relates to timing. It has been suggested, for example, that customers may not be willing to sign a contract before they are ready to implement a financial adviser's recommendations. This could create a chicken-and-egg dilemma, where the adviser can't get a signed contract in place until they have provided recommendations, and can't provide recommendations until a contract has been signed. In our view, it isn't absolutely crucial that a contract be in place before any advice is rendered, as long as the legally binding agreement covering all advice rendered is in place before any investment based on that advice is implemented. As part of any such contract, the firm and its advisers must be required to represent or acknowledge that they are acting in a fiduciary capacity, that they are legally bound by the impartial conduct standards and the warranties in the BIC when their recommendations are implemented, and those standards and warranties apply retroactively to cover the

recommendations themselves. Under such an approach, retirement investors would have the necessary protections in place when it counts, before they act on any advice they receive.

Another argument put forward by many in the financial industry is that getting contracts in place with millions of existing retirement advice customers would be virtually impossible. Their argument seems to hinge largely on the fact that millions of retirement savers will simply fail to respond to requests to sign contracts. Without their signature, firms would not be allowed to provide investment advice pursuant to conflicted compensation models. While we recognize that requiring retirement savers to sign the BIC has benefits – primarily that it alerts them to the legal protections to which they are entitled – it does not appear to us to be crucial to its enforceability. Retirement investors are not the "party to be charged" under the law. Rather, it is the firm and the adviser who are bound by the terms in the contract. In this respect, the contract should be viewed as unilateral in nature, whereby the recommendation is an offer inviting acceptance through performance, and the retirement investors' implementation of that recommendation is the acceptance. Alternatively, we think it could be possible to achieve the same result without a written contract between the firm, adviser, and retirement saver. Principles of estoppel would dictate that if a firm and its adviser represent they are acting in a fiduciary capacity and complying with the impartial conduct standards and the warranties in the BIC, and a retirement investor justifiably relies on those representations by implementing the adviser and firm's recommendations to her detriment, the firm and its adviser should be estopped from later denying fiduciary status or having made those representations.

Given that we do not believe retirement investors would have to sign a legal contract for that contract to be enforceable, we think the burdens of getting a legally enforceable document in place could be streamlined, particularly for existing customers. Existing customers could be mailed a change in terms notice outlining the new obligations the firm would be required to undertake under the BIC. As long as no new obligations or restrictions were placed on the customer, this approach should be acceptable. For new customers, we believe firms are likely to have their own reasons to want to get a contract in place, if only to require the customer to sign a pre-dispute binding arbitration clause. Where this is the case, the BIC can and should be included as part of the other account opening paperwork the customer is required to sign. Where this is not the case, the accommodations suggested above with regard to the timing of the contract should be sufficient to address any concerns about getting a contract in place with new customers.

The approaches suggested above address situations in which the retirement saver has a direct relationship with the fiduciary investment adviser. For retirement plan participants, however, the retirement saver may have only an indirect relationship with the adviser through their employer. Since servicing contracts in the plan context are between a firm and the employer, it should be possible to use that contract as the basis for providing plan participants with legally enforceable protections under BIC. For example, instead of requiring all the different prospective parties to the contract to sign that contract, the firm could name the employees as third-party beneficiaries to the contract. Such an approach could significantly reduce the burdens of getting a contract in place. In order to put plan participants on notice that they are entitled to legal protections under BIC, they could be provided with a series of written representations based on the BIC at the time they open an account or (where they are

automatically enrolled) when they receive their first account statement or other paperwork related to the account.

The suggestions provided above are not the sole means of getting a legally enforceable agreement in place. We encourage the Department to explore various alternatives to determine which provide the best combination of workability and legal enforceability.

B. The Rule Must Include a Best Interest Standard.

Compliance with the BICE requires adherence to certain specified impartial conduct standards when providing fiduciary investment advice. These include, first and foremost, an obligation to provide advice that is in the best interest of the retirement investor, but also to receive only reasonable compensation in light of services provided and to refrain from making misleading statements. Failure to comply with these standards would result in loss of the exemption, which helps to ensure that they will be taken seriously by financial advisers who rely on the BICE. We strongly support these requirements, which are essential to protect against the harmful consequences associated with conflicted advice. The impartial conduct standards, discussed here, and the required warranties, discussed below, are essential building blocks that reinforce each other, creating a framework of meaningful protections that should help to ensure retirement investors' interests are paramount.

Best Interest Standard: The rule defines best interest advice as advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor. This best interest standard effectively mirrors the ERISA section 404 duties of prudence and loyalty, which have provided effective safeguards for plans and plan participants for forty years. Importing this proven standard into the IRA market will provide retail retirement investors with the same, much needed protections.

Importantly, the proposal makes clear that a recommendation is assessed for compliance with the best interest standard based, not on the outcome of that recommendation, but on the circumstances prevailing at the time the recommendation is made. Thus, hindsight is irrelevant to how a recommendation is gauged. This is both appropriate and directly contrary to claims by some in the financial industry that the rule exposes advisers to liability based solely on the outcome of their investment recommendations. As the Department notes in the proposing release, courts have extensive experience interpreting this standard. In general, they focus on whether the fiduciary employed appropriate procedures to investigate the merits of the recommended investment. Thus, as discussed above, claims that the standard will expose advisers to a flood of litigation have no basis in either the regulatory language or past experience of those subject to the same standard.

Finally, the rule requires that the advice be made "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." This "without regard to" language is critically important in the context of conflicted advice, because it provides concrete protections against an adviser's recommending a product based on personal financial considerations rather than the interests of the customer. Including this

language as part of the impartial conduct standards should help to rein in common industry practices that are designed to pressure or incentivize advisers to recommend products for reasons other than the best interests of the investor. It is worth noting that, when members of the broker-dealer community express support for a "best interest" standard, they typically omit this crucial language, suggesting that the "best interest" standard they support is one that doesn't actually require meaningful changes in current, often harmful business practices.[96] However, this same language is mirrored in the securities law concept of a best interest standard for fiduciary investment advisers as reflected, for example, in Section 913 of the Dodd-Frank Act. Thus, the rule's best interest standard is consistent with the standard that the SEC would apply if it were eventually to adopt rules under its Section 913 authority. It is frankly disingenuous for industry groups to state that they support a best interest standard based on securities law principles, then oppose the very standard Congress identified as appropriate for this purpose.

C. Compensation Must Be Limited to What is Reasonable.

Another critically important component of the impartial conduct standards is the requirement that firms agree that their advisers will not make recommendations in which the total amount of compensation anticipated to be received by any adviser, the firm, or its affiliates will exceed reasonable compensation in relation to the total services provided to the retirement saver. As the DOL makes clear, the reasonableness of the fees depends on the particular facts and circumstances. Although many in the financial industry have expressed a significant amount of bewilderment about what "reasonable compensation" means, how this standard would be applied, and how the industry could comply with it, the reasonable compensation standard is in fact well-established in law and in practice.

As the DOL notes, the obligation to pay no more than reasonable compensation is long recognized under ERISA and the rules promulgated pursuant to ERISA. For example, ERISA section 408(b)(2) allows a plan to pay a party in interest for services rendered if several conditions are met, including if "no more than reasonable compensation is paid therefore."[97] In addition, ERISA section 408(c)(2) states that nothing shall prohibit plan fiduciaries from "receiving any reasonable compensation for services rendered."[98] And, shortly after ERISA's passage, the DOL clarified what constitutes reasonable compensation, stating -- just as it has in this proposal -- that it "depends on the particular facts and circumstances of each case."[99]

Furthermore, the DOL has reiterated its adherence to the reasonable compensation standard repeatedly. For example, in a 1997 Advisory Opinion, the DOL stated that if a plan service provider receives a payment from a third party, that payment must be taken into account in determining whether compensation paid is reasonable.[100] Moreover, in a 2002 Field Assistance Bulletin, it stated that ERISA's fiduciary duties require a responsible plan fiduciary, when selecting or monitoring service providers, to engage in "an objective process designed to

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[96] *See, e.g.*, SIFMA, "Proposed Best Interests of the Customer Standard for Broker-Dealers," June 3, 2015, http://bit.ly/1M56eog.

[97] Section 408(b)(2) of the Act, codified as 29 U.S. Code § 1108 - Exemptions from prohibited transactions, implemented through 29 CFR Part 2550.408b-2(a)(2), http://1.usa.gov/1TO66i3.

[98] Section 408(c)(2) of the Act, codified as 29 U.S. Code $1108 –Exemptions from prohibited transactions.

[99] *Id.*, implemented through 29 CFR Part 2550.208c-2(b)(1) through 2550.208c-2(b)(4).

[100] DOL Advisory Opinion 97-15A (May 22, 1997), http://1.usa.gov/1SxjCEb.

elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fees charged in light of the services provided."[101]

The standard strikes an appropriate balance, helping to discipline excessive costs but not requiring the lowest cost option in every instance. Experience in the plan context demonstrates that the reasonable compensation standard does not necessarily require the lowest cost option. In fact, the DOL confirmed this principle when it provided guidance under ERISA section 408(b)(2), stating, "a fiduciary need not necessarily select the lowest-cost service provider, so long as the compensation or fees paid to the service provider are determined to be reasonable in light of the particular facts and circumstances."[102] And, as experience in the plan context further demonstrates, there is a wide disparity in the costs that plan sponsors and participants pay for the services they receive. This has been documented in research by ICI and Deloitte on retirement plans' all-in costs[103] and in a 2006 GAO report that examined the various fees associated with 401(k) plans.[104] According to the GAO report, while the DOL's "most recent in-depth review of fees identified some plans with high fees, it determined that they were not unreasonable or in violation of ERISA."

It is true that in recent years there has been a growth in private litigation relating to various 401(k) fee arrangements, but it is too early to tell what effect those cases will have on 401(k) plan fees more broadly. Because each of those cases is based on its unique facts and circumstances, the results may not offer much clarity. But no one expects courts to require plans to adopt the lowest cost option in every circumstance. On the other hand, the court cases are likely to have a salutary effect on the market, pushing plans to discipline costs so as to ensure that they are meeting the reasonable compensation requirement. Those same dynamics would benefit retirement investors in the retail market.

Indeed, the real reason behind industry's expressed concern over this "reasonableness" standard is not that it is too vague, in our view, but that it calls into question certain common industry practices that drive up costs to retirement savers. As the DOL states, the reasonableness of a fee must be considered in relation to the value of the services being provided. Under common industry practices, however, an adviser and the adviser's firm can be paid vastly different sums for providing exactly the same services, depending solely on the particular investment recommended. This is an inherent feature of a market in which products compete to be sold, not bought, and do so on terms that are favorable to the adviser, rather than the investor. The rule would help to rein in such practices by prohibiting advisers and their firms from taking outsize payments for recommending certain products that go well beyond the reasonable compensation justified by the time spent or the difficulty of the analysis behind the recommendation. Similarly, a reasonable compensation standard calls into question the common industry practice of receiving on-going compensation for a one-time transaction. How, for example, would financial advisers justify a one-time recommendation that a buy-and-hold

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[101] DOL Field Assistance Bulletin 2002-3 (Nov. 5, 2002), http://1.usa.gov/1Mklwt7

[102] Preamble to DOL Regulation Section 2550.408b-2, Section B-1.(g)

[103] Press Release, "Retirement Plan Fees Vary with Plan Size and Diversified Equity Holdings, Deloitte/ICI Study Finds," August 20, 2014, http://bit.ly/1Kgd7Gw.

[104] Government Accountability Office, Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees, November 2006, http://1.usa.gov/1OhH5rO.

retirement investor purchase mutual fund C shares with a one percent 12b-1 fee for the life of the investment, when they provide no ongoing account oversight and have no ongoing duty of care?

Some in the industry have urged the Department to bless existing compensation practices as inherently "reasonable," on the grounds that they do not violate existing securities and insurance laws and regulations. We strongly disagree. Failure to rein in these harmful practices is just one of the many ways in which securities and insurance regulators have failed to provide appropriate protections for consumers and investors. The DOL rule offers a welcome antidote to their weak and ineffective regulation in this regard. On the other hand, because this requirement does take financial firms into new territory, it may be helpful for the DOL to issue guidance as it implements a final rule that provides examples of the types of compensation practices the DOL would view as running afoul of the reasonable compensation rule.

D. The Best Interest Standard Must Be Backed Up by Restrictions On Industry Practices that Conflict with Customers' Interests.

The best interest standard is, by its very nature, subject to interpretation. In a business model replete with conflicts of interest, there will be overwhelming incentives to try to justify recommendations that are suboptimal for the retirement investor, but highly profitable for the adviser or the firm. The rule proposal recognizes that the key to making the best interest standard real for sales-based advisers is reining in the practices that encourage these advisers to act in ways that are not consistent with their clients' best interests. The reasonable compensation and "without regard to" language of the impartial conduct standards should help to achieve that goal. But another crucial component is the BICE requirement that financial firms contractually warrant that they have adopted written policies and procedures that are reasonably designed to mitigate the impact of material conflicts of interest that exist with the provision of retirement investment advice.

To comply, firms must identify material conflicts of interest and adopt measures to prevent those material conflicts of interest from causing violations of the impartial conduct standards. In addition, the financial institution "must state that neither it nor (to the best of its knowledge) its Affiliates or Related Entities will use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differentiated compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the best interest of Retirement Investors." This requirement, even more than the best interest requirement itself, will force firms that rely on the exemption to take concrete, meaningful steps to eliminate practices that exacerbate potentially harmful conflicts.

These types of firm compensation policies that reward activities that are harmful to clients' interests are rampant in the market today.[105] Below are a few examples, taken from firms' Form ADV Part 2A and other public disclosures discussing affiliated broker-dealer activities:

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[105] *See, e.g.*, Various Firms' Payout Grids, OnWallStreet.com, http://bit.ly/1QcCxbj.

- Wells Fargo: "From time to time, we initiate incentive programs for our Associates, including FAs.... FAs who participate in these incentive programs may be rewarded with cash and/or non-cash compensation, such as deferred compensation, bonuses, training symposiums and recognition trips. Portions of these programs may be subsidized by external vendors and/or our affiliates, such as mutual fund companies, insurance carriers, or investment advisers. Therefore, FAs and other Associates may have a financial incentive to recommend the programs and services included in these incentive programs over other available products and services we offer."[106]

- Edward Jones: "Internal Incentive Programs – We may o-ffer internal incentive programs that may provide financial advisors and branch office administrators with an opportunity to earn additional compensation or prizes."[107]

- USAA: "In particular, an FAI Representative's eligibility to participate in certain USAA bonus plans is dependent upon his or her individual performance rating which measures a variety of factors, including...sales of USAA products and services....FAI Representatives may also receive non- cash rewards, such as team meals or conference participation, for meeting individual and/or team performance goals."[108]

- Northwestern Mutual: "Your Representative may also receive bonus, transition, retention or other compensation ... in connection with the sales and servicing of various investment products. The rate of compensation paid to NMIS registered representatives increases if revenue generated from the sales and servicing of various investment products and advisory services meets or exceeds certain thresholds. As an agent of NM, your Representative accrues production credits arising out of the sale of all risk-based insurance products in the aggregate, including annuities that are being serviced by an advisory program. NM rewards its agents for achieving certain levels of production credits with non-monetary rewards and recognition such as being invited to conferences, receiving gifts and being given preferential service by the Home Office."[109]

- PNC: "From time to time, PNC Investments initiates incentive programs for its employees including FAs [Financial Advisors] or other PNC Investments representatives. These programs include, but are not limited to, programs that compensate them for attracting new assets and clients or for referring business to our affiliates ... and programs that reward FAs or other PNC Investments representatives who meet total production criteria. FAs or other PNC Investments representatives who participate in these incentive programs may be rewarded with cash and/or non- cash compensation, such as deferred compensation, bonuses, training symposiums and recognition trips. These programs may be partly subsidized by external vendors or our affiliates, such as mutual fund companies, insurance carriers or money managers. Therefore, our FAs or other PNC Investments representatives and other associates may have a financial

[106] Part 2A of Form ADV Firm Brochure for: Wells Fargo Financial Planning Services, at 10, March 2015.
[107] Understanding How We Are Compensated For Financial Services, at 2, http://bit.ly/1Vlt0ip.
[108] Part 2A of Form ADV Firm Brochure for: USAA Financial Planning Services Insurance Agency, Inc., at 5, April 1, 2015.
[109] Part 2A of Form ADV Firm Brochure for: Northwestern Mutual Investment Services, LLC, at 24, April 1, 2015.

incentive to recommend the programs and services included in these incentive programs over other available products and services that we offer."[110]

- UBS: "Financial Advisors also may receive certain awards based on their production amount, length of service with UBS, business mix and net new assets. ... In addition, Financial Advisors acting as Insured Solutions Consultants ("ISCs") receive additional production credits for the sales of certain insurance products."[111]

- Schwab: "In addition, from time to time, one or more categories of our representatives may participate in short-term, temporary incentive programs focusing on a particular class of products or services, including new accounts and new assets to Schwab. ... Certain representatives who demonstrate exceptional performance during the year may also be eligible to earn an annual trip through Schwab's Chairman's Club, or other awards. Schwab may develop additional recognition events or programs from time to time."[112]

- Fidelity: "Fidelity employees may participate in incentive contests and may earn various non-cash rewards based on customer investments in products and services and other criteria, including but not limited to the number of referrals for particular programs or services that they make or customer investments in certain types of products or services. Such reward programs will generally rank representatives or teams against other eligible representatives or teams and determine the eligibility for rewards based on that ranking. Therefore, representatives may have a financial incentive to offer those programs, services or products."[113]

While not all such incentive programs would necessarily violate the standards, many would. For example, some firms set quotas for the sale of certain investment products and base advisers' bonuses or payouts on their success in meeting quotas. Such practices would appear to be a clear violation of the rule proposal. Similarly, firms would be hard pressed to justify continued use of contests or other incentives to encourage the sale of particular products or product lines. We strongly support such restrictions as a necessary step to help ensure that retirement investors no longer receive recommendations that are driven by an adviser's desire to win a contest or receive a bonus, rather than the customer's financial interests.

The rule proposal also tackles the use of differential compensation, which is so central to the conflicts that can bias sales-based advisers' recommendations. Specifically, while firms could still pay their advisers differential compensation, those differential payments would have to be based on neutral and objective factors, such as the amount of time necessary to research and implement the investment strategy, and not just on a desire to promote sales of particular investments. This would be a significant improvement from the way compensation is currently provided, which creates incentives to sell products that are not in retirement savers' interest.

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[110] Part 2A of Form ADV Firm Brochure for: PNC Investments LLC, at 8, May 15, 2015.
[111] Part 2a of Form ADV Firm Brochure for: UBS Financial Planning Services, at 10, March 31, 2015.
[112] Investment Professionals' Compensation, Schwab, http://bit.ly/1OrXLxv.
[113] Introduction to Representatives' Compensation, Fidelity, http://bit.ly/1Gw8VLb.

Below are a few examples, taken from firms' Form ADV Part 2A and other public disclosures discussing how compensation policies create conflicts of interest:

- MetLife: "As a result of such additional compensation being paid for the sale of products or services to implement the Financial Plan, a conflict of interest arises. In other words, the additional compensation gives Financial Planner and MSI an incentive to recommend products and services to implement the Financial Plan based on the compensation received, rather than on a client's needs."[114]

- Ameriprise: "Ameriprise Financial Services and the financial advisor receive more compensation on fund or share classes that pay higher fees. Ameriprise Financial Services and the financial advisor generally receive less compensation when the sales charge and/or 12b-1 fee is reduced, waived completely, or where there is no sales charge. Therefore, there is an incentive for our financial advisors to sell a fund from a load fund family or a fund that pays a 12b-1 fee over one that does not … which may influence your financial advisor to recommend certain funds or classes over others."[115]

- JPMorgan: "However, our interests may not always be the same as those of brokerage clients, as we may be paid both by them and by other parties who compensate us based upon what the brokerage clients purchase, and our profits and salespersons' compensation may vary by product and over time."[116]

- UBS: "The compensation structure may create financial incentives for Financial Advisors to encourage clients to purchase multiple products and service or to choose a method of payment for products and services that generate compensation in excess of that for other products."[117]

- RBC: "The differences in compensation create an incentive for financial advisors to recommend products for which they receive higher compensation. … This will add to the overall compensation that we receive and may present a conflict of interest based on an incentive to recommend investment products based on the compensation received, rather than based on your needs."[118]

- Schwab: "Some of these compensation plans are based on revenue Schwab earns from clients or from product sales, and Schwab may pay a Schwab representative more for selling products or services on which Schwab makes more money."[119]

- Fidelity: "As disclosed in this document, representatives who offer certain services may receive compensation as a direct or indirect result of your selection of those services.

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[114] Part 2A of Form ADV Firm Brochure for: Financial Planning Services MetLife Securities, Inc., at 11, January 1, 2015.
[115] Part 2A of Form ADV Firm Brochure for: Ameriprise® Financial Planning Service, at 18, March 30, 2015.
[116] Part 2A of Form ADV Firm Brochure for: J.P. Morgan Securities Portfolio Manager Program, at 37, March 31, 2015.
[117] Part 2A of Form ADV Firm Brochure for: UBS Financial Planning Services, at 10, March 31, 2015.
[118] Part 2A of Form ADV Firm Brochure for: RBC Capital Markets, LLC Financial Planning, at 6, March 31, 2015.
[119] Investment Professionals' Compensation, Schwab, http://bit.ly/1OrXLxv

> This compensation may be more than what the representative would receive if you participated in other programs or services. Therefore, representatives may have a financial incentive to offer certain programs or services."[120]

Given the pervasiveness of such practices, it should come as no surprise that many financial firms have expressed vehement opposition to this component of the rule. In addition to making false claims that the rule would prohibit differential compensation entirely, they have argued that the restrictions are too vague or unworkable. Even the industry's self-regulator, FINRA CEO Rick Ketchum, expressed the view that the BICE as currently written doesn't "really describe a broker-dealer model that I'm aware of."[121] But that, of course, is precisely the point: the regulation is designed to change current practice, not bless it. By suggesting, as FINRA does in its comment letter on the rule, that differential compensation should be accepted as an unavoidable conflict, FINRA provides a clear an example of why DOL should not defer to securities regulators' "leadership" in adopting an appropriate standard to govern conflicted advice.

Indeed, if there is a problem with the rule's provisions regarding differential compensation, it is that they may not go far enough. We are concerned, for example, that allowing differential compensation based on neutral and objective factors may implicitly condone and encourage the sale of more complex, higher cost products, such as annuities, where higher compensation levels could be justified based on the argument that those products take more time than other products to explain and understand. We hope that the other requirements of the BICE would mitigate the potential abuse that could result from improperly relying on the neutral and objective factors language. In our view, however, the only way to ensure that advisers are not tempted to rationalize recommending more complex, high cost products is to level the compensation that they receive for all of the products that they recommend.

Despite the fact that the proposal is crystal clear that differential compensation would be permitted, some industry participants nonetheless have claimed that the only way they could ensure compliance with the policies and procedures warranty would be to fee-level at a firm level. They have pointed to the examples of broad approaches to compensation structures that the DOL has offered to illustrate how firms might satisfy their policies and procedures. While it is true that those examples are rigorous, the DOL made clear that they "are not exhaustive, and many other compensation and employment arrangements may satisfy the contractual warranties." We also find it ironic that after the DOL provided exactly what the industry asked for -- a principles-based approach that provides firms flexibility to accommodate their various business models -- many industry participants have argued that they need more and clearer guidance regarding how to comply.

Insofar as the industry has gotten one thing right with regard to the policies and procedures requirement, fee-leveling at a firm level would be the clearest, simplest, and most effective way to root out conflicts. Short of that, however, fee-leveling at the adviser and branch manager levels would be the most targeted, bang-for-the-buck approach. Combined with the

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[120] Introduction to Representatives' Compensation, Fidelity, http://bit.ly/1Gw8VLb.

[121] Melanie Waddell, "FINRA's Ketchum Criticizes DOL Fiduciary Plan," *Investment Adviser Magazine*, May 1, 2015, http://bit.ly/1bT12rH.

rule's restrictions on using quotas, bonuses, personnel decisions and other factors to incent recommendations that are not in a customer's best interests, such an approach would create an appropriate amount of breathing room that would help to insulate recommendations from being based on financial incentives that are designed to serve firm revenue goals.

Some firms already fee-level to varying extents at the adviser level, which suggests it would be eminently feasible to expand on this approach. For example, with regard to mutual funds, Stifel Nicolaus states in its customer agreement disclosures that its "compensation formula does not favor one fund or fund family over another, and commission revenue is paid out to your Financial Advisor on the same basis regardless of the fund family, similar to any commission revenue received by the firm."[122] Likewise, with regard to insurance products, "Stifel's compensation formula does not favor one insurance company's products over another. All commission revenue is paid out to the Financial Advisor on the same basis."[123] While some of those differences in compensation among types of investments may be justified on neutral terms, others arguably would not. However, the fact that some firms have successfully adopted models that move in this direction suggests that still more could be accomplished if there were regulatory pressure to do so.

We hope that, through the comment process and the Department's ongoing engagement with affected parties, new suggestions will emerge for methods of appropriately constraining compensation-related conflicts. If so, we would encourage the Department to provide additional guidance regarding acceptable conflict mitigation practices. One thing that should be absolutely clear, however, is that the industry's preferred approach of requiring disclosure and consent to material conflicts is grossly insufficient. Such an approach would do nothing to actually change the types of firm policies and practices that create and exacerbate conflicts of interest. Furthermore, as discussed above in the Seller's Carve-out section of this letter, extensive academic and empirical evidence shows that disclosure is ineffective at best, and harmful at worst. Accordingly, the DOL should resist any suggested changes by industry to water down the policies and procedures warranty requirement by requiring only disclosure and consent to material conflicts of interest.

E. Other Provisions of the BICE Help to Strengthen and Reinforce Its Central, Essential Requirements.

While we view the above provisions as absolutely essential to the BICE's effectiveness, we also strongly support other aspects of the proposed rule that help to reinforce these central components. These include provisions that limit the types of investments that advisers can recommend when they are receiving conflicted compensation, that impose additional requirements with regard to recommendations from a limited menu of proprietary products, and disclosures designed to better inform retirement investors of the costs of their investments and the conflicts that could influence their adviser's recommendations.

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[122] Stifel Account Agreement and Disclosure Booklet, http://bit.ly/1IehGPw.
[123] *Id.*

1. We support strengthened protections to counteract the significant conflicts associated with recommendations of proprietary products and from a limited menu of products.

The conflicts inherent in sales-based advice can be exacerbated when the adviser sells from a limited menu of products or sells proprietary products, regardless of whether those products are part of a limited menu. To combat the problem, the rule requires a financial institution relying on the BICE to make a specific written finding that the limitations do not prevent the adviser from providing advice that is in the best interest of retirement investors or from otherwise adhering to the impartial conduct standards. Payments received in connection with these limited menus must be reasonable in relation to the value of specific services provided and cannot exceed the services' fair market value, a more specific than is otherwise required under the reasonable compensation standard. Advisers would be required to disclose the extent to which the financial institution places limits on the investment products they are able to offer. And, as an added crucial protection, the adviser would have to notify the retirement investor if the firm did not recommend a sufficiently broad range of investment options to meet the investor's needs. CFA strongly supports the proposed approach which, while it permits recommendations based on a limited menu of products, appropriately protects against the enhanced risks associated with that business model.

While some firms recommend only proprietary products, many others sell proprietary products alongside non-proprietary products. In many such cases, advisers receive additional compensation or other incentives from their firm for selling proprietary products. Even where an individual adviser's compensation is unaffected, advisers may nonetheless be pressured by their superiors to sell proprietary products over non-proprietary products, based on firm revenue considerations. These incentives can make it exceedingly difficult for advisers to provide recommendations that are in retirement savers' best interests.

Firms' ADV Form disclosures illustrate the types of conflicts that may be present when they sell proprietary products:

- Wells Fargo: "Products recommended by us may include proprietary products of us or our affiliates. You should note that we have an incentive to recommend proprietary products because we or our affiliates earn more compensation from the sale of these products than from the sale of non-proprietary products."[124]

- AXA: "Financial Professionals may receive other compensation and benefits related to the sales of proprietary products. Accepting this type of compensation may present a conflict of interest in that there is an incentive to recommend investment products based on the compensation received, rather than on a client's needs."[125]

[124] Part 2A of Form ADV Firm Brochure for: Wells Fargo Financial Planning Services, at 10, March 2015.
[125] Part 2A of Form ADV Firm Brochure for: AXA Advisors, LLC, at 16, March 31, 2015.

- MetLife: "Thus, your Financial Planner has a conflict of interest when recommending the sale of affiliated securities or insurance products as a registered representative or as an insurance agent."[126]

- Putnam: "Compensation may include commissions based on the successful sale of particular Putnam funds or strategies/services. Accordingly, Putnam personnel have an incentive to sell Putnam products and services."[127]

- Ameriprise: "Ameriprise Financial Services has a financial interest in the sales of proprietary products that are manufactured by its affiliates."[128]

- USAA: "The revenues of FPS and FAI are primarily derived from the sales and service of USAA products and services."[129]

- RBC: "This may raise a conflict of interest as we may be incented to recommend the RBC Funds over a non-RBC Fund."[130]

Given the potential harm to investors when firms sell proprietary products rather than superior non-proprietary products, it is appropriate that, before recommending such products, an adviser must satisfy all the requirements of the BICE, including those that apply to recommendations from a limited menu. These additional requirements are necessary and appropriate to protect retirement investors' interests and ensure that, regardless of the limited options their advisers are recommending from, they are still receiving best interest advice and their particular needs are being met.

2. We support limitations on the types of investments that can be recommended subject to conflicted compensation.

The rule proposal restricts the types of investments that advisers can recommend when they receive conflicted advice to a group of specific assets listed in the proposed rule. Contrary to some industry claims, it does not in any way restrict the types of assets that retirement savers can choose to invest in, where they make independent choices about their retirement investments, nor does it restrict the types of investments that advisers can recommend when they do not receive conflicted payments. The DOL's stated purpose for this listing approach is threefold: first, the list captures those investments that are commonly purchased by plans, participant and beneficiary accounts, and IRAs; second, it ensures that the investments needed to build a basic diversified portfolio are available to plans, participant and beneficiary accounts, and IRAs; and third, the list limits the exemption to those investments that are relatively transparent and liquid, many of which have a ready market price.

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[126] Part 2A of Form ADV Firm Brochure for: Financial Planning Services MetLife Securities, Inc., at 14, January 1, 2015.
[127] Part 2A of Form ADV Firm Brochure for: Putnam Investment Management, LLC, at 23, March 30, 2015.
[128] Part 2A of Form ADV Firm Brochure for: Ameriprise® Financial Planning Service, at 18, March 30, 2015.
[129] Part 2A of Form ADV Firm Brochure for: USAA Financial Planning Services Insurance Agency, Inc., at 4, April 1, 2015.
[130] Part 2A of Form ADV Firm Brochure for: RBC Capital Markets, LLC Financial Planning, at 11, March 31, 2015.

Some in the financial industry have claimed that the list of permissible assets under the BICE significantly and inappropriately restricts what advisers can recommend to their clients, thus hindering their ability to serve their clients. Despite such claims, however, the list of permissible assets that can be recommended pursuant to the BICE is extensive. It includes, for example: bank deposits, certificates of deposit (CDs), exchange-listed stocks, mutual funds, exchange-traded funds (ETFs), exchange-traded Real Estate Investment Trusts (REITs), registered corporate bonds, Treasuries, and annuities. The list of permissible assets does not include: private placements, non-traded REITs, private equity, or hedge funds. For a large majority of retirement savers, such assets have no place in their retirement accounts. Instead, they are traditionally reserved for more sophisticated and wealthier investors, who can sustain significant potential losses without jeopardizing their retirement security.[131] These assets also typically have extraordinarily high fees for investors and, as a result, lofty commissions for advisers and their firms. We therefore agree that the increased risks associated with recommendations of such investments by conflicted advisers outweigh the limited benefits of making them available under the BICE for the small percentage of retirement savers for whom they would be appropriate.

While we commend the DOL for seeking to achieve the vital goals discussed above, the DOL correctly notes that many investment types and strategies that would not be considered permissible assets if invested in directly can be obtained through pooled investment funds, such as mutual funds, which are considered permissible assets. As a result, the list is not nearly as limiting as industry opponents have suggested, but it is also vulnerable to being circumvented and thus may not offer the protections that the DOL seeks to achieve. For example:

- While an adviser would not be able to recommend purchasing private placements or non-traded REITS under the BICE, the adviser could recommend purchasing a closed-end fund holding private placements or non-traded REITS.

- Similarly, while an adviser would not be able to recommend purchasing futures or options (i.e. derivatives), the adviser could recommend purchasing a leveraged ETF to gain the same type of exposure.

- In addition, municipal bonds are not included in the permissible list of assets, ostensibly because most municipal bonds are tax exempt and thus duplicate the tax benefits associated with retirement accounts, thus decreasing their benefit and rendering them ill-suited for a retirement account. Just as in the other cases, however, an adviser could get around this restriction by recommending an open-end municipal bond fund.

These are just a few of the examples that we've come up with to circumvent the list. We have no doubt clever financial advisers and their firms will think of others. On the other hand, if the apparent reasoning for excluding municipal bonds – that they already receive a tax-advantage, which effectively reduces the investor's yield, thus rendering them inappropriate for retirement

[131] According to the industry's own arguments, such investors are likely to invest through fee-based accounts, which would generally be unaffected by the restrictions.

accounts – were to apply to other tax-preferred assets, tax-deferred annuities would also be excluded from the list of permissible assets.

Because the DOL's listing approach may not achieve the agency's goals and is likely to result in an intense and interminable lobbying campaign from various product providers to have their products placed on the list of permissible assets, we think another approach might be warranted. As with other requirements of the BICE, this approach would be principles-based, such that for an adviser to recommend a certain asset pursuant to the BICE, that asset must:

- Have an observable market price (transparent pricing);
- Be capable of being sold in the secondary market at or near its fair market value within a reasonably short amount of time (sufficient liquidity);
- Be transparent and not excessively complex in structure;
- Have a sufficient track-record to demonstrate its utility;
- Not be excessively leveraged; and
- Not provide a redundant or illusory tax-benefit inside a retirement account.

These principles should apply to both the underlying assets within a pooled investment vehicle and to the investment vehicle itself, unless the vehicle provides benefits (e.g., liquid secondary market and transparent pricing) absent in the underlying asset. If a firm can't show why an asset its advisers are recommending satisfies these principles, there should be an inference that the asset is incapable of satisfying the best interest of any retirement investor.

Based on our review of the proposed asset list, almost all of those assets would satisfy the principles discussed above. However, depending on what underlying assets comprise certain closed-end funds or ETFs, they may not satisfy the principles. For example, if a closed-end fund included non-traded REITs, because the underlying assets do not meet the principles, the asset should not satisfy the principles. In addition, inverse and triple-leveraged ETFs should not satisfy the principles because of their excessive leverage. Furthermore, new, untested products such as exchange traded managed funds (ETMFs), should not satisfy the principles because they don't have a sufficient track-record to demonstrate their utility and they do not in fact have the transparency that they claim.[132] Finally, tax-deferred products, such as annuities, would likely have trouble satisfying the "redundant or illusory tax-benefit" restriction. We believe a strong principles-based approach, such as the one we have suggested, will better achieve the DOL's goals, while still allowing firms flexibility to recommend a wide variety of products appropriate to retirement savers.

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[132] While these funds advertise as having "NAV-based trading," an investor does not actually buy at the NAV at the time of the purchase. Rather, the NAV that the investor is buying (and doesn't know) is the NAV at the end of the day on which the purchase is made.

3. Proposed disclosures provide an important supplement to the best interest standard and conflict restrictions.

The proposed BICE includes a set of required disclosures designed to provide greater transparency around the costs and conflicts associated with retirement investment advice. These requirements directly address the problem, discussed above, that many retirement savers (like investors more generally) do not understand the costs of either the investments they purchase or the services of financial professionals they turn to for advice, do not understand the long-term impact of those costs on their retirement savings, and do not understand either the extent or nature of the conflicts that could bias the recommendations they receive. While disclosure alone is not adequate to ensure that retirement savers can protect their own interests, enhanced disclosure can provide a useful supplement to the proposed rule's other more central protections (e.g., best interest standard, mitigation of conflicts).

Well-designed disclosures can benefit retirement savers in two basic ways. Direct disclosures can alert individuals to issues they might otherwise have ignored, in this case issues regarding costs and conflicts. To achieve this goal they must provide individuals with the information they need, in a form they can understand, and at a time when it is useful to them in making an investment decision. The less the individual has to do to track down and decipher the information, the more likely it is to be effective in supporting informed decision-making. But even where individuals do not make good use of direct disclosures, they can still benefit from the enhanced transparency that public disclosures provide. Public disclosure can be effective, for example, in promoting cost competition that brings down costs even for those who do not make cost-conscious decisions. Public disclosure requirements can also cause firms to abandon practices that, while legal, are embarrassing in a field that likes to promote an image of professionalism and reliability.

The Department's task in creating effective disclosure is made more challenging by the unnecessary complexity of industry compensation practices and by the failure of securities and insurance regulators either to rein in harmful conflicts or to adopt effective cost and conflict disclosures. Despite those challenges, the Department has proposed a disclosure regime that includes both actionable information for individual retirement savers and enhanced transparency that should help to bring the forces of market competition to bear to the benefit of all plans, plan participants and IRA investors. The proposed disclosure requirements include the following key components:

- Website Disclosure

The rule requires that financial institutions maintain a regularly updated and easily accessible public website that shows the compensation payable to the adviser, the financial institution and any affiliate for services provided in connection with each asset made available to plans, plan participants or IRA investors. Disclosures must be provided for each asset made available either currently and over the preceding 365 days. All direct and indirect material costs must be provided for each asset unless costs are uniform across a class of assets, in which case disclosure by asset class would suffice. The compensation may be expressed as a monetary

amount, formula or percentage of the assets involved in the purchase, sale or holding, and the webpage must include a version of the information in a machine readable format.

The required website disclosures are key to providing the transparency that can help to bring market forces to bear on industry practices. As noted above, even investors who never review these disclosures may benefit if the resulting transparency helps to promote cost competition in an area – compensation for advice – that has traditionally been opaque and, as a result, largely immune to these competitive forces. Moreover, we agree with the Department that the requirement that information be provided in machine readable format should make it possible for financial information companies to analyze the cost data and provide information comparing the practices of different advisers and financial institutions. Individual retirement savers and plan fiduciaries alike should benefit from services that help them to evaluate costs and compensation practices.

- Contract Disclosures

The contract mandated under the BICE includes required disclosures with regard to both costs and conflicts. Specifically, the disclosures must identify all material conflicts of interest. These may be described in general terms as long as the contract also discloses that a more specific description of conflicts is available on the financial institution's website, including a web address where the information can be found, and by mail upon request. In keeping with the requirement to disclose conflicts, the written contract must indicate whether the financial institution offers proprietary products or receives third party payments. Finally, the contract must inform the advice recipient that he or she has the right to obtain complete information about all of the fees currently associated with the assets in which the account is invested, including all of the fees payable to the adviser, financial institution, and any affiliates and related entities in connection with such investments.

SEC focus group research on investors' disclosure preferences suggest that retirement savers would appreciate these upfront disclosures with regard to compensation and conflicts. For example, one focus group participant stated: "I think that before you start with them that they should be able to disclose what their conflicts are before you even start. I think requiring them to initially tell you what the conflicts are would be an easy way to solve it and have it noted." Another stated: "I think at the beginning that you have a dialogue with that person, and then right at the time when you're about to buy something."[133] It is this potential to cause investors to ask questions or start a discussion regarding costs and conflicts that is likely to be the primary benefit of these contract disclosures.

While we hope that the required contract disclosures will drive advice recipients to ask questions and dig more deeply with regard to costs and conflicts, this is far from guaranteed. General disclosures of the type anticipated here are often overlooked or ignored, particularly as they tend to be written in bland legalese that fails to convey the importance of the information. Given the variety of business models among firms likely to rely on the BICE, however, it seems impractical to try to overcome this problem by proscribing set disclosures. The requirement that

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[133] Siegel & Gale, LLC, *Investor Research Report*, Submitted to the Securities and Exchange Commission on July 26, 2012, http://1.usa.gov/1MfBbss.

the web address be included with the disclosures should at least help to ensure that retirement savers who are interested in researching costs and conflicts do not have to go searching far and wide for the relevant information. This requirement to include the web address is essential to the disclosures' effectiveness and should be retained in a final rule.

- Individual Transactional Disclosure

Those who wish to rely on the BICE must also provide detailed cost information in advance of any transaction for which they provide fiduciary advice. The disclosure must cover the all-in costs of the proposed transaction, including the anticipated costs of the investment for 1-, 5- and 10-year periods. These costs must be expressed as a dollar amount and must be based on the dollar amount recommended by the adviser and reasonable assumptions regarding investment performance, which must be disclosed. The disclosures would have to be provided "in a time frame that would enable the Retirement Investor to discuss other (possibly less costly) alternatives with the Adviser prior to executing the transaction."

Requiring pre-sale, dollar amount disclosures of investment costs has long been a priority of investor advocates. Although the SEC issued a proposal for point of sale disclosure of mutual fund costs during the early years of the Bush Administration, nothing ever came of it. Similarly, the SEC has failed to act on the Dodd-Frank Act's explicit authorization to require pre-sale disclosures for investment products and services, even though its own research shows that investors prefer to receive information in advance of the sale. The transactional disclosures proposed by DOL will help to fill that void by providing retirement savers with actionable information at a time when they are most likely to be able to make good use of it.

The key to providing effective cost disclosure is to report costs in dollar amounts, in a form that is, to the extent possible, easily comparable across assets, and to provide the information at a point where it can be factored into the investment decision. The DOL rule proposal meets all these standards for effective disclosure. First, it requires costs to be disclosed not simply as percentages, but as dollar amounts. This is critical to promoting investor understanding. Research has shown that the "absolute magnitude effect" – the tendency for people to perceive numbers as the absolute value of the quantities inherent in them, and not as the actual statistical figures they represent – can affect investors' perceptions of numerical values such as investment returns and, by extension, costs. As researchers who have examined this phenomenon explained, this causes a person "to perceive a larger change in their portfolio if the return was expressed as 24 percent versus an identical return of 0.24" and to "perceive an even larger change if it was expressed in a dollar amount as long as the change was more than $24."[134] The same is certain to hold true for costs, which are more likely to be understood and less likely to be dismissed as insignificant if they are presented as dollar amounts.

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[134] LoMando, Joseph, "Tips 401k Plan Sponsors Can Use to Help Employees Avoid Risk Aversion," *Fiduciary News*, October 4, 2011. The article discusses several academic papers: "Presenting Investment Results Asset by Asset Lowers Risk Taking," (Anagol and Gamble 2009); "Numerical Information Format and Investment Decisions: Implications for the Disposition Effect and the Status Quo Bias," (Rubaltelli et al., *The Journal of Behavioral Finance*, 2005, Vol. 6, No. 1, 19–26); and "Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience," (Agnew and Szykman, The Journal of Behavioral Finance, 2005, Vol. 6, No. 2, 57–70)." This information is based on the discussion of Rubaltelli et al.

Disclosing costs in dollar amounts also greatly increases the ease of comparison across assets and asset classes. This enhanced ability to compare costs is of critical importance, since many retirement savers are unlikely to understand without guidance whether a particular cost is high or low or somewhere in between. This is true with regard to investment costs, but even truer with regard to costs for advice. As discussed above, a significant percentage of investors currently believe the advice they receive is provided free of charge. Others know they are paying something, but don't know how much. This has protected financial advisers from the cost competition that would come with better disclosure and enable broker-dealers to maintain the myth that their services are generally less costly than those of fiduciary advisers. Finally, requiring the disclosures to be based on the suggested investment amount will further enhance investor understanding.

We are particularly pleased that the Department also proposes to provide disclosures that highlight the long-term impact of costs. This will further increase the likelihood that retirement savers will factor costs into their investment decision. We have heard some in industry suggest that they can't provide these disclosures without violating FINRA rules, presumably because the rule suggests that the firm select (and disclose) a reasonable rate of return in order to calculate the long-term costs when making the disclosures. To the degree that this is a genuine concern, the DOL can easily overcome it by specifying a rate of return for use in making such calculations. This would increase comparability and reduce the risk that firms would use rates of return for this purpose that are designed to minimize the cumulative costs. Given the limitations in these estimates, it would be important to require that the disclosures make clear that these are estimates and that actual costs may be lower or higher. While the resulting information would be an imperfect predictor of long-term costs, it would be a significant improvement over the status quo.

Finally, in providing pre-sale disclosures, timing is crucial. If the goal is to encourage advice recipients to review the information carefully, it is essential that the information be provided, not in a flurry of paperwork at the point of finalizing the transaction but rather, as the proposed rule requires, with sufficient time for the advice recipient to consider the information and factor it into their investment decision. We have long preferred the point of recommendation, rather than point of sale, as the appropriate time for such disclosures. However, while the rule provides somewhat more flexibility with regard to timing of disclosures, it is consistent with the principle of allowing time for consideration and discussion of the disclosed information. Because the information is specific to each transaction, it should be required to be provided with each transaction, and not simply in limited circumstances, such as account opening or rollover.

This pre-sale timing of disclosures, while it has been resisted in the past by industry, enjoys strong support among investors. The SEC Financial Literacy Study states, for example, that: "Generally, retail investors prefer to receive disclosures before making a decision on whether to engage a financial intermediary or purchase an investment product or service."[135] For example, asked about their preference regarding delivery of compensation information, 71.3 percent of survey respondents indicated that they want to receive information on how they will

[135]Siegel & Gale, LLC, *Investor Research Report*, Submitted to the Securities and Exchange Commission on July 26, 2012, http://1.usa.gov/1MfBbss.

pay for services before they begin the relationship. They made it clear, moreover, that they want some time to think about the information. Among those who said they want the information prior to beginning the relationship, just under a third said they want it at least a day or two in advance (32.7 percent) and four in ten (40.8 percent) said they want it at least a week before they begin the relationship.

The Department asks whether a "cigarette style" warning would be as effective as but less costly than actual cost disclosures. While such a warning would certainly be less costly than the proposed cost disclosures, it would also be significantly less effective. Experience tells us that investors are far less likely to go in search of information than they are to read information that is provided to them directly. Indeed, there is no evidence that these sorts of generic warnings have any meaningful impact on investor behavior. We would strongly urge the Department against adopting this far inferior approach. Retirement savers deserve real, actionable information about their investment costs, not boilerplate warnings.

- Individual Annual Disclosure

The proposal backs up its requirement for pre-sale disclosure with a requirement that the adviser or financial institution provide annual cost disclosures to advice recipients covering the costs and compensation associated with all assets purchased or sold by the plan, plan participant or IRA investor over the previous year. The disclosures must: list the price at which each asset was bought or sold; must include a statement of the total dollar amount of all fees and expenses paid with respect to each asset purchased, held or sold during the applicable period; and must include a statement of the total dollar amount of all compensation received by the adviser and financial Institution, directly or indirectly, from any party, as a result of each asset sold, purchased or held by the plan, participant or beneficiary account, or IRA, during the applicable period.

While the pre-sale disclosures regarding long-term costs would necessarily be estimates, the mandate to provide annual disclosures would provide an opportunity to provide greater clarity around the actual costs paid by the retirement saver. As such, although our priority is ensuring that retirement savers get good cost information before they invest, the annual cost disclosures would serve as a useful supplement to the pre-sale disclosures.

We have no doubt that industry will suggest, with regard to both the pre-sale and the annual cost disclosures, that it is either not possible or too costly to provide the desired information. But any difficulty in providing these disclosures is driven by the complexity of a compensation system that seems at times to have been adopted with the express purpose of obscuring the costs of financial advice. The disclosures could provide an additional secondary benefit if the obligation to disclose drove industry to simplify its unnecessarily complex compensation practices.

4. CFA supports the rule's data request.

A final condition of the BICE is that it requires firms that rely on the exemption to maintain certain data for six years. We strongly support the data request as essential to the

Department's ability to assess the impact and effectiveness of the rule. Financial firms have created a Catch 22 when it comes to adopting regulations designed to improve consumer and investor protections. First, they demand that regulators justify their rules based on a thorough economic analysis. As the DOL knows from direct experience, the firms then refuse to provide the data that would support a robust economic analysis. When the agency produces an economic analysis based on available data, they then cite the data limitations to suggest that the analysis is insufficiently rigorous or otherwise lacks merit, using their own highly selective and skewed data to refute it. The only way regulators can protect against such practices is to build data requests into their regulations, ensuring that they will have access to the information they need to accurately assess and monitor the effectiveness of their regulatory efforts. The rule's data request should go a long way to addressing these concerns.

5. Industry complaints about the workability of the rule should be taken with a grain of salt.

Before the Department released its revised rule proposal, the industry's key argument against the rule was that it would make it impossible for financial professionals who receive conflicted payments to serve this market because it would prohibit all conflicted payments. And they maintained that argument even in the face of repeated pledges by DOL officials that they intended to adopt PTEs to permit commissions and other forms of transaction-based compensation. Had concern about their ability to earn conflicted payments been the real issue, release of the BICE should have put that argument to rest. Instead, industry has simply adjusted the rhetoric around their campaign to have the rule withdrawn. Their new mantra is that the rule is "unworkable" and that it will let loose a flood of litigation, with the ultimate effect that it will force advisers who receive conflicted payments to abandon this market. Neither argument holds water, as we discuss in further detail below. Even in those few instances where their concerns have at least some basis in reality, there is nothing industry groups have raised with regard to the workability of the rule that couldn't easily be addressed through the rulemaking process. That is, after all, what the rulemaking process is for. Instead, this line of argument allows firms to oppose the rule without acknowledging that their real fear is that it would force them to change practices that are highly profitable for them, though considerable less beneficial for their clients.

a) There is no basis for industry claims that the rule will lead to increased litigation.

Industry has seized on the BICE's contract provision, which provides a means for holding firms and advisers legally accountable, to argue that the rule will "unleash a flood of litigation." While it is true that retirement savers with meritorious claims should find it easier to recover their losses if the rule is adopted, there is simply no basis for the claim that the rule would lead to an upsurge in litigation. To suggest that it would ignores not only the high cost of pursuing claims, and the particular difficulty of pursuing class action lawsuits, but the plain language of the rule itself.

Perhaps the most extreme of the claims with regard to litigation risk is that financial professionals will be vulnerable to lawsuits anytime their customers lose money on an investment they recommended or make less money than they could have made had they invested differently. This is patently absurd. There is no evidence that investment advisers who are

subject to a best interest standard under securities laws face such claims. Indeed, the rule proposal poses even less of a threat of such litigation than the securities law best interest standard, since it does not automatically impose an ongoing duty of care on ERISA fiduciaries. Only where the adviser agrees by contract to provide ongoing account oversight would he or she have to monitor the recommendation to ensure that it continues to serve the best interests of the customer. Absent such an agreement, there would be no ongoing duty under the proposed rule and thus no basis for a claim. Moreover, compliance with the standard would be determined based, not on the outcome of the recommendation, but on whether an impartial expert would view the recommendation as having been made in the best interest of the customer in light of prevailing circumstances at the time of the recommendation. Customers who wish to bring a case based solely on the outcome of the investment would be unlikely to find an attorney willing to represent them. Because of the unlikelihood of success, attorneys whose pay typically depends on the outcome of the claim would have no incentive to take such a case.

With equally little basis in fact, some opponents of the rule have suggested that the provision prohibiting advisers from forcing customers to sign away their right to participate in class action lawsuits represent a broad new expansion of liability. In reality, however, this provision merely reaffirms existing FINRA policy under the securities laws, which already prohibits broker-dealers from placing any such limitations on customer rights. There are two main reasons to believe class actions will remain the rare exception, rather than the rule. The first is that very few cases will lend themselves to class treatment. The second is that even cases that lend themselves to class treatment face significant barriers.

Claims based on violation of fiduciary duty turn on whether the recommendation was in the best interest of the customer. That is a very fact-specific determination that will differ for each customer based on his or her personal situation and needs. However, an attorney seeking to certify a class must prove commonality of the harm suffered throughout the class. As a result, the vast majority of claims based on violation of fiduciary duty simply will not lend themselves to class treatment and will continue to be brought as individual claims in arbitration.

Moreover, class actions face daunting procedural barriers that often prevent such actions from moving forward. First, a judge must approve of the formation of a class and allow the named plaintiff to bring the action on behalf of the class. For this to occur, a representative plaintiff must prove commonality of harm among class members, that the class is so numerous that it is impracticable to bring suit otherwise, that the claims or defenses of the named plaintiff are typical of the claims or defenses of the class, and that the named plaintiff will fairly and adequately represent and protect the interests of the class.[136] Most classes seeking money damages also require a judge to find that issues common to the class members predominate over issues affecting individual members and that a class action is superior to other available methods of adjudicating the controversy.[137] If a class manages to clear these hurdles and is certified by a judge, a defendant can appeal the court's decision, which can tie up the case and increase costs for a named plaintiff and his or her attorneys.[138] The appeals process can delay, and often cripple

[136] Fed. R. Civ. P. 23(a).
[137] Fed. R. Civ. P. 23(b)(3).
[138] Fed. R. Civ. P. 23(f).

the progress of a class action, turning it into a battle of attrition where the party with the most resources (usually the defendant) wins.

As a practical matter, smaller firms simply do not have a big enough client base to make class treatment worthwhile. Instead, the most likely class action target under the proposed rule would be a large firm that, in clear violation of the rule, adopts policies and practices that encourage their advisers to provide conflict-ridden retirement investment advice. For example, a large firm that continued to use quotas and bonuses to encourage the sale of in-house products across its IRA platform could be vulnerable to class action litigation. Similarly, a large firm could face class action litigation if it relied on the best interest contract exemption to engage in widespread sale of products that are clearly not permitted under that exemption, such as non-traded REITS. These are precisely the sorts of situations where class actions provide an appropriate and effective mechanism to hold firms accountable for compliance with the rule.

For the reasons noted above, most claims brought under the rule proposal are likely to be individual claims. Because the DOL's proposal specifically allows firms to include pre-dispute binding arbitration clauses in their contracts, the vast majority of these claims will likely be heard in the industry-run FINRA arbitration forum rather than in court. Although arbitration is promoted as providing an inexpensive alternative to court, the costs are sufficient to deter even small meritorious claims, let alone the frivolous claims industry argues are a threat under the DOL rule proposal. For example, a combination of filing fees, discovery costs, expert witness fees, hearing session fees, and costs for a court reporter can easily add up to $30,000 before attorney's fees, according to attorneys who are familiar with the system. Most attorneys work on a contingency fee, which means they agree to front a significant portion of the litigation costs in return for receiving reimbursement and a percentage of any recovery. Cases have to be worth their time, effort, energy and resources, otherwise they aren't going to invest in them. As a result, they have little if any incentive to take cases unless they expect to win and to win an award sufficient to cover the considerable costs of bringing the claim. Alternatively, an attorney can charge by the hour. That can add up very quickly to tens of thousands of dollars in legal bills that all but the wealthiest claimants will be unable to afford. If, despite these deterrents, an investor brings a frivolous claim, that investor may be responsible for paying the other side's attorneys fees, possibly amounting to an additional tens of thousands of dollars.

Furthermore, real-world evidence demonstrates that concerns about the industry's claims regarding excessive litigation risk are drastically overblown. Investment advisers are fiduciaries under the securities laws and thus subject to a best interest standard, yet they do not face an outsize liability risk. Many broker-dealers are dually registered as investment advisers and are thus accustomed to operating in a fiduciary capacity, with regard to fee-based or discretionary accounts for example. Moreover, a leading claim brought against broker-dealers in arbitration (regardless of whether they are dually registered as advisers) is violation of fiduciary duty, often based on a claim that the broker held out as providing on-going account management and then failed to do so. Despite this broad fiduciary exposure, FINRA's own dispute resolution statistics show quite convincingly that these broker-dealers are not exposed to excessive litigation risk. In each of the past three years, for example, between 1,873 cases and 2,216 cases that involved breach of fiduciary claims were filed.[139] While significant, this is nowhere near the "flood of

[139] FINRA, Dispute Resolution Statistics, http://bit.ly/1ebKRGF.

litigation" that the industry claims is likely to occur if brokers are subject to a fiduciary duty under ERISA.

We've heard these same, baseless industry arguments before, when it was suggested for example that fee-based accounts should be regulated as advisory accounts. The broker-dealer industry claimed that they'd be subject to excessive litigation risk, costs would increase for customers, and they would no longer offer fee-based accounts to investors. Here are just a few examples of the claims the industry made, which bear an uncanny resemblance to the claims they are making today regarding the DOL's proposed rule.

- According to the law firm Morgan Lewis, "The combination of the views expressed in the adopting release and the media focus on these accounts may expose broker--dealers to heightened litigation risk for fee--based accounts if they elect to continue to offer these accounts absent additional regulatory relief.[140]

- According to Chip Roame, head of Tiburon Strategic Advisors, a California-based industry research and consulting firm, "This is definitely increasing their reps' liability. ...We're going to see firms losing more and more lawsuits."[141]

- Ira Hammerman, General Counsel of what was then the Securities Industry Association, which became SIFMA, stated that, "Converting fee-based brokerage accounts to advisory accounts "would likely work to the disadvantage of customers, who, as a result, could face increased costs or who could lose their chosen forms of brokerage accounts to the extent their broker-dealer determined not to continue to provide those forms of accounts rather than effect such conversion [to advisory accounts].[142]

- Marc E. Lackritz, president of the Securities Industry Association stated that, "Placing broker-dealers that offer fee-based brokerage accounts to their clients under an additional, and wholly unnecessary, layer of regulation could have severely limited the availability of these popular accounts."[143]

- In another letter by Hammerman: "The forced closure of this brokerage pricing avenue would be a major loss of client choice and a significant diminution in both pricing and account management flexibility that clients have come to expect and enjoy."[144]

This is a mere snapshot of the claims that were made suggesting that regulating fee-based accounts as advisory accounts would lead to increased liability and cost investors access to valued services. Although the SEC bowed to industry pressure, their position was later

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[140] Morgan Lewis Securities Industry FYI, "Implications of the D.C. Circuit's Decision Vacating Rule 202(a)(11)-1," April 6, 2007, http://bit.ly/1CSrDSb.
[141] Susan Konig, Managers Learn To Live Without "The Merrill Lynch Rule," WealthManagement.com, http://bit.ly/1VlhJyp.
[142] Letter from Ira D. Hammerman, Senior Vice President and General Counsel, Securities Industry Association, to the SEC, February 7, 2005, http://1.usa.gov/1DqoYdi.
[143] FPA Mulls Action After SEC Ruling, Financial Advisor, http://bit.ly/1CLoXpF.
[144] Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, to the SEC, June 27, 2007, http://1.usa.gov/1fhDmPb

overturned in court. Since the U.S. Court of Appeals for the D.C. Circuit ruled in 2007 that fee-based accounts are advisory accounts, none of the parade of horrors that the broker-dealer industry predicted actually occurred. In fact, the number of fee-based accounts and the level of assets in fee-based accounts at broker-dealers have grown dramatically. Cerulli Associates found that, even after the broad market declines of 2008, the client assets in non-discretionary advisory accounts rose by almost 75 percent from approximately $329.6 billion at the end of the conversion process in 2007 to $574 billion in the third quarter of 2012.[145] Meanwhile, the level of fees charged to customers for this service model at the major national firms has stayed flat or decreased since 2007. In short, DOL should recognize that the industry has a long record of crying wolf in this regard and should not give such claims credence that they simply do not deserve.

One over-looked aspect of the rule proposal is its potential to reduce litigation by reducing predatory practices. In a recent letter to members, FINRA's Ketchum noted that firms could significantly reduce their compliance problems and regulatory risks if they would put the interests of their customers first.[146] By requiring firms to take concrete steps to eliminate practices that encourage bad conduct, the rule proposal achieves what FINRA only suggests. Moreover, it would not only require firms and advisers to put customer interests first, it would also require firms to eliminate the practices that encourage advisers to act in ways that are not in the customer's best interest. By reducing the incentives to steer clients into inferior investment options, the rule should reduce abusive conduct. As a result, firms that take seriously their obligation to mitigate conflicts and put the interests of customers first should see their liability risks reduced as a result of the better outcomes they achieve for clients.

While there is no reason to believe the proposed rule would increase the amount of litigation, it should improve the ability of those with meritorious claims to recover losses sustained as a result of abusive retirement investment advice. As a recent study by the Public Investors Arbitration Bar Association documented, the same financial professionals who routinely market themselves as objective advisers putting their customers first immediately drop that pose in arbitration and deny any such obligation. Because the rule proposal would force financial professionals who receive conflicted compensation to sign a contract in which they acknowledge their duty to give fiduciary advice, plaintiffs would no longer have to prove that a fiduciary relationship existed. Instead, it would be enough to show a violation of the standard, rather than that the standard applies.

Financial professionals who take advantage of retirement savers' trust should be held accountable for their abusive conduct. The rule proposal provides that accountability without posing any credible threat of excessive litigation or frivolous claims. Industry claims to the contrary are simply scare tactics designed to cover for their real concern, which is that they simply do not want to be legally accountable for putting the interests of their customers first.

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[145] As referenced in the Financial Planning Coalition letter to the SEC, Cerulli Associates, Cerulli Quantitative Update: Advisor Metrics, Exhibit 1.02 (2012).

[146] FINRA, 2015 Regulatory and Examination Priorities Letter, January 2015, http://bit.ly/1F8782M.

b) *Where justified, concerns about the rule's "workability" can be addressed through relatively minor revisions to the rule proposal.*

While much of the industry's argument that the rule is unfounded consists of little more than overblown rhetoric, there are three issues that industry has raised that are based on at least a grain of truth.[147] All can easily be addressed through technical corrections or clarifications.

First, as currently drafted, the rule does not permit financial firms and advisers who receive conflicted payment to provide advice to plan sponsors who are acting on behalf of participant-directed plans with fewer than 100 participants. This results from the fact that advice to such plans does not qualify for either the Seller's Carve-out or the BICE. Employers would still be able to receive advice from fiduciary advisers who do not receive conflicted payments. And those who are willing to take on some responsibility for selecting investment options will be able to receive non-fiduciary services under the Platform Providers Carve-out. However, there may be small employers who prefer, for whatever reason, to receive fiduciary advice from a financial firm receiving conflicted compensation. The answer is not, as industry suggests, to make the Sellers Carve-out universally available. A better approach is to expand the BICE to cover investment advice provided to sponsors who are acting on behalf of participant-directed plans.[148]

Second, some industry participants have claimed, we believe mistakenly, that the BICE is unavailable for rollover recommendations. Their claim hinges on the strange reasoning that "the exemption applies to advice relating to the purchase, sale, or holding of certain assets," and that such an "asset-based approach means that the exemption does not apply to distribution or rollover advice."[149] A rollover necessarily requires the sale and purchase of assets, and so long as the assets being recommended are those that the DOL deems permissible, we see no reason why rollover recommendations should not be covered by the BICE. To the extent the Department believes any clarification would be helpful in dispelling this misunderstanding, however, we encourage you to provide that clarification.

Third, as discussed above, questions have been raised about the timing of the contract and the best way to implement that requirement, particularly with regards to plan participants and existing customers. While we believe the legal enforceability provided by the contract requirement is central to the rule's effectiveness, we remain open to approaches that would create added flexibility around the timing and mechanisms for implementing that contract so long as they do not dilute or diminish the legal enforceability of the fiduciary obligations.

There have also been some questions as to whether registered investment advisors (RIAs) who recommend rollovers to their customers should be required to claim relief under the BICE

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[147] A fourth issue that has been raised under the mantra of workability -- the question of whether firms could market their services without triggering a fiduciary duty -- is addressed above in the section of the letter devoted to the definition of fiduciary investment advice.

[148] *See supra* Seller's Carve-out discussion explaining why small plan fiduciaries' general lack of financial expertise and sophistication renders them ill-suited for the Seller's Carve-out.

[149] Kent Mason, "Department of Labor's Re-proposed Definition of a Fiduciary Widely Prohibits Personalized Investment Assistance Even if the Assistance is in the Customer's Best Interest," Davis and Harman, LLP, April 20, 2015, http://bit.ly/1JbLXil.

or another applicable PTE. We believe they should. The recommendations that they make affect their own compensation, and therefore pose a conflict of interest. For example, if a client rolls over a $250,000 account to the RIA and the RIA charges one percent per year for assets under management, the RIA stands to make $2,500 per year on the client.[150] In contrast, if the client does not roll over her account, the RIA will make nothing. As a result, the RIA's recommendation to roll over poses an acute conflict that would trigger a prohibited transaction that must be adequately protected to ensure that the recommendation is in the client's best interest. Assuming the conflicted rollover transaction meets the requirements of the BICE, the RIA would need to claim relief for only that transaction, as his compensation would afterwards revert to a largely unconflicted payment model. With this analysis in mind, to the extent an RIA provides a recommendation relating to taking a distribution, the BICE should apply.

IV. Principal Transactions Exemption

The rule proposal includes an exemption to permit investment advice fiduciaries to sell certain fixed income (debt) securities to retirement plans and IRAs out of their inventory. Because advisers who sell out of inventory may be able to dictate unilaterally the price that investors pay and charge them more than is appropriate, enhanced protections are necessary to ensure the transactions being recommended and executed aren't disadvantageous to retirement investors.

A. Principal Trading Poses a Risk of Abuse that Warrants Enhanced Protections.

Principal trading creates opportunities for advisers to take advantage of their clients. The classic and perhaps clearest example is when an adviser "'dump[s]' unmarketable securities or securities that the adviser believes may decline in value into a customer's account."[151] However, as we have noted in several comments to the SEC on the matter, "While [dumping] might have been the primary potential abuse that principal trading created in simpler times, the potential for abuse arising from principal trades today is far broader and more varied than mere dumping. Advances in technology, speedier transactions, increased market volatility, more diverse trading platforms and other factors have brought benefits to the markets while also presenting more, and more complex, opportunities for principal trading abuses."[152]

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[150] This hypothetical assumes the RIA does not receive any third party payments. However, there is a growing wave of RIAs who do receive such payments. *See, e.g.,* Mason Braswell, Custodians payments to RIAs for fund picks raise eyebrows, Investment News, June 26, 2015, http://bit.ly/1eerBJ0. In the case in which an RIA receives third party payments, they should be required to continue claiming relief under the BICE, as their conflicts are no different than broker-dealers' or insurance agents', and we find the SEC's approach to this issue, requiring mere disclosure, insufficient to protect retirement investors' interests.

[151] SEC Proposed Rule: Temporary Rule Regarding Principal Trades With Certain Advisory Clients, Release No. IA-3893; File No. S7-23-07, http://1.usa.gov/1I7aJve .

[152] September 17, 2014 Letter from Barbara Roper, Director of Investor Protection of Consumer Federation of America, to Securities and Exchange Commission Secretary Elizabeth Murphy, http://1.usa.gov/1OhNOSA; *See also* November 30, 2007 letter from Mercer Bullard, Founder and President of Fund Democracy, and Barbara Roper, Director of Investor Protection of Consumer Federation of America, to Securities and Exchange Commission Secretary Nancy M. Morris, regarding File No. S7-23-07, http://1.usa.gov/1RJM3ng.

Debt securities are among the investments most commonly sold to investors on a principal basis. This is partly due to the fact that certain debt securities, including corporate bonds, are seen as less liquid than stocks, which is itself a result of a lack of standardization among products.[153] Another contributing factor is a regulatory inconsistency in disclosure requirements that creates an incentive for firms to execute trades in a principal capacity. Under SEC Rule 10b-10, a firm is required to disclose on its customer's trade confirmation the transaction costs the customer paid for stock transactions, regardless of whether the firm executed the transaction in an agency or principal capacity. However, for bond transactions, a firm is only required to provide the customer's transaction costs on its customer's confirmation if the firm executed the transaction in an agency capacity. Thus, if a broker-dealer arranges a bond trade for a customer on an agency basis, the broker must disclose the transaction costs he or she paid, reflected as a commission. However, if a broker-dealer arranges a bond trade for a customer on a principal basis, the dealer has no duty to disclose the transaction costs the customer paid, reflected as a markup or markdown. Thus, a firm can treat functionally equivalent transactions differently depending on how it chooses to characterize the transaction.[154]

Given this regulatory inconsistency, which allows firms to choose whether their clients receive confirmation disclosure of the costs they are paying, it is hardly surprising that firms execute virtually all customer fixed income securities transactions in a principal capacity. This allows firms to effectively withhold information from their clients that their clients would find useful. Consequently, firms are able to charge more than they otherwise would if they provided that cost information to their clients. More broadly, this disclosure loophole has helped to foster a market structure that preferences the trading of debt securities on a principal, rather than an agency basis. The result is an antiquated, over the counter, dealer-driven fixed income market that benefits the bond dealers who have an informational advantage over their customers.

Theoretical and empirical evidence suggests that, as a result of the opacity in fixed income markets, financial intermediaries are able to extract rents from their less sophisticated retail customers by charging them what appear to be excessively high transaction costs in fixed income markets. The price discrepancies further suggest that there are not sufficient protections designed to ensure that principal trades are executed in the best interests of investors, much less designed to ensure that principal trading abuses are rooted out. SEC Commissioner Michael Piwowar arguably has done more than anyone in recent years to highlight the ways in which retail investors have been harmed in fixed income markets. In 2007, Piwowar astutely observed: "Bond markets have been notoriously opaque....The lack of transparency in the bond markets has allowed market professionals – including sophisticated investors, brokers and dealers – to obtain vast sums of money from unsophisticated investors and taxpayers."[155] It is inevitable that, as a result of the market opacity, retail investors are unaware of instances in which principal trades with their broker-dealer were not in their best interests.

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[153] *See* Remarks by SEC Commissioner Daniel M. Gallagher, A Watched Pot Never Boils: the Need for SEC Supervision of Fixed Income Liquidity, Market Structure, and Pension Accounting, March 10, 2015, http://1.usa.gov/1OrRW2Y.

[154] The SEC adopted Rule 10b-10 in 1977. Commissioner Piwowar has referred to this issue as an opportunity to "pick low hanging fruit." Remarks by SEC Commissioner Michael S. Piwowar, Advancing and Defending the SEC's Core Mission, January 27, 2014, http://1.usa.gov/1Ien0lP.

[155] Piwowar, Michael S., Corporate and Municipal Bonds, Securities Litigation and Consulting Group, Inc., 2007, http://bit.ly/1CwCN9V.

A 2007 paper by Piwowar, Harris, and Edwards examined corporate bond transactions in 2003 and found that the average effective spread on a $20,000 corporate bond trade was 1.24 percent of the price, making it the equivalent of over two months of the total annual return for a bond with a 6 percent yield to maturity.[156] Putting that cost in perspective relative to today's interest rates, it is equivalent to almost 5 months of the total annual return for a bond with a 3 percent yield to maturity. In comparison to a similar-sized equity trade, Piwowar, Harris, and Edwards found that this cost would be equivalent to an effective spread of 52 cents per share. The researchers also found that trading costs decrease dramatically with trade size, meaning that retail investors generally pay substantially more than institutional investors to trade a bond. This is in stark contrast to equity markets, in which retail investors generally pay lower transaction costs than institutional investors to buy and sell stocks due to the lower price impact of trading smaller amounts.

B. Current Regulatory Efforts, While Helpful, are Insufficient to Ensure Transactions are in Retirement Investors' Best Interests.

FINRA currently has efforts under way both to increase post-trade transparency of markups and to enforce its 5 percent markup policy, which is designed to require firms to buy and sell at prices that are fair and reasonable. In July 2002, Transaction Reporting and Compliance Engine (TRACE) began requiring bond dealers to report transaction data in U.S. corporate bonds in near real-time to what was then the National Association of Security Dealers (now FINRA), which made that transaction data available to the public for free. While overall bond trading costs have fallen as a result of increased price transparency, the evidence suggests that those benefits have not been noticeable for all investors. According to SEC Commissioner Piwowar, while institutional and sophisticated investors have seen their bond trading costs fall, retail investors' trading costs remain high. This is likely because institutional and sophisticated investors know that TRACE exists, know how to access the information on the site, and know how to interpret the transaction information that they find in order to gauge whether they are paying fair prices. Most retail investors, on the other hand, likely do not know TRACE exists and, even if they did, are not in a position to use the website with any reasonable degree of expertise. As a result, they likely are not able to realize the benefits that TRACE can offer.

FINRA has recently proposed to provide certain markup disclosures for same-day trades directly to retail investors, which marks an improvement over the status quo. The information that would be provided to retail investors would no doubt put them in a better position to understand the costs they are paying and to assess whether those costs are reasonable. However, while disclosure is an essential investor protection tool that can increase the likelihood that investors make more informed choices, disclosure alone will not effectively mitigate the risks to retirement investors posed by excessive markups in fixed income markets.

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[156] Edwards, Amy, Harris, Lawrence and Piwowar, Michael, "Corporate Bond Market Transaction Costs and Transparency," Journal of Finance 62, 1421-51 (2007), http://bit.ly/1Bb6y0y.

Similarly, FINRA recently has engaged in zealous enforcement of its 5 percent markup policy,[157] and has even instituted proceedings against firms for excessive markups and markups that are significantly below the 5 percent threshold.[158] Furthermore, FINRA has recognized that, since the policy was first instituted in 1943, advances in information and communication technologies, and member firms' front and back office technologies, have significantly reduced execution costs.[159] As a result, 5 percent is significantly higher than the average markup, markdown or commission currently charged by most member firms in customer transactions. Despite these efforts, FINRA may not be catching all instances of excessive markups. According to a recent Wall Street Journal article, "Bond-pricing service DelphX LLC found more than 60 transactions between October and November featuring markups above Finra's guideline. One broker paid 21 cents on the dollar for $50,000 of bonds from now-bankrupt oil and gas concern Endeavor International Corp., when four minutes earlier it had charged an investor 25.1 cents for the same amount of the same bonds, earning a 19.52% markup."[160]

Thus, while we commend FINRA's efforts to improve the fixed income market structure generally, they are insufficient to ensure retirement investors' best interests are being protected when their fiduciary adviser buys from them or sells to them fixed income instruments on a principal basis.

C. The DOL Has Proposed a Sensible Framework to Protect Retirement Savers from Principal Trading Abuses.

Given the constraints of the market structure and the SEC's apparent lack of appetite to fix even the most basic deficiencies in this market, we sincerely appreciate the DOL's efforts to mitigate the potentially severe conflicts of interest that exist for principal transactions. Unlike the anemic approach to principal trading regulation under securities laws, which is premised on the faulty notion that investors can make an informed choice about engaging in principal transactions if they are provided with prior notice, the DOL's approach does not rely exclusively on disclosure and consent. Instead, it incorporates concrete safeguards to prevent principal trading abuses.

First, we agree that, as with the Best Interest Contract Exemption, there must be a legally enforceable mechanism to hold advisers and their firms accountable for abuses. This includes

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[157] *See, e.g.,* Press Release, "FINRA Fines Oppenheimer $675,000 and Orders Restitution of More Than $246,000 for Charging Unfair Prices in Municipal Securities Transactions and for Supervisory Violations," December 9, 2013, http://bit.ly/1TMfLp9; Press Release, "FINRA Fines StateTrust Investments $1 Million and Orders $353,000 in Restitution for Charging Unfair Prices in Bond Transactions," June 26, 2013, http://bit.ly/1Dqr0KA; Press Release "FINRA Sanctions David Lerner Associates $14 Million for Unfair Practices in Sale of Apple REIT Ten and for Charging Excessive Markups on Municipal Bonds and CMOs," October 22, 2012, http://bit.ly/1MDksgU; Press Release, " FINRA Fines Citi International Financial $600,000 and Orders Restitution of $648,000 for Excessive Markups and Markdowns," March 19, 2012, http://bit.ly/1OhP6wW; Press Release, "FINRA Fines Morgan Stanley $1 Million and Orders Restitution of $371,000 for Excessive Markups and Markdowns," November 10, 2011, http://bit.ly/1Gw02Bb

[158] Lisa Abramowicz, Bond Markups as Low as 3% Said Excessive to Finra in Trading, Bloomberg, May 16, 2014, http://bloom.bg/1TMgree

[159] FINRA Regulatory Notice 13-07: Markups, Commissions and Fees, January 2013, http://bit.ly/1TMgAOK.

[160] Katy Burne and Aaron Kuriloff, Regulators Want Data on Bond-Trade Fees, Wall Street Journal, January 13, 2015, http://on.wsj.com/1SxqZeT.

acknowledging fiduciary status with regard to the investment recommendation regarding principal transactions; contractually committing to adhere to standards of impartial conduct when providing advice regarding principal transactions; and complying with the warranty requirements. The DOL should make clear that in addition to complying with these requirements when providing advice about principal transactions, advisers and firms must also comply with these requirements when executing principal transactions. Thus, in addition to the advice regarding principal transactions, the actual transactions that flow from that advice that must reflect the retirement savers' best interest. Further, the DOL should clarify that, as part of the warranty requirement, firms must develop policies and procedures that are specifically designed to detect, deter, and prevent disadvantageous principal transactions for retirement savers.

Second, the list of assets that may rely on the principal trading exemption is appropriately narrow and limited to the types of securities that are most likely to be held in retirement accounts and least likely to be subject to principal trading abuses. This includes Treasury securities, agency debt securities, and registered corporate debt securities. Thus, municipal securities cannot claim relief under the exemption. This is appropriate, in our view, since these securities are notoriously involved in principal trading abuses.[161] Furthermore, at least in the case where they are tax-exempt, their tax benefit results in decreased interest and all income distributed from an IRA is still taxable, regardless of the fact the interest was tax-exempt when earned. These factors render municipal securities ill-suited for retirement accounts in most circumstances. In addition, more complex and exotic types of debt, such as collateralized debt[162] and private placements, are also appropriately outside the scope of the exemption.

Next, the proposal requires that the debt securities being bought and sold pursuant to the exemption possess no greater than moderate credit risk and have sufficient liquidity such that the securities can be sold at or near their fair market value within a reasonably short period of time. We believe that these additional protections beyond the list of permissible assets will ensure that the securities being traded on a principal basis have a strong likelihood of meeting their financial obligations and trade in sufficiently liquid markets so that the fairness of the security's price can be ascertained and evaluated. As a practical matter, these protections are highly unlikely to constrain principal trading in Treasury securities and agency debt securities. Treasuries and Ginnie Mae securities are backed by the full faith and credit of the U.S. Government and are therefore considered to possess the lowest credit risk of any securities. Similarly, agency debt

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[161] *See, e.g.*, FINRA enforcement actions, Press Release, "FINRA Fines Oppenheimer $675,000 and Orders Restitution of More Than $246,000 for Charging Unfair Prices in Municipal Securities Transactions and for Supervisory Violations," December 9, 2013, *supra*; Press Release, "FINRA Sanctions David Lerner Associates $14 Million for Unfair Practices in Sale of Apple REIT Ten and for Charging Excessive Markups on Municipal Bonds and CMOs," October 22, 2012, *supra*; Press Release, "FINRA Fines Morgan Stanley $1 Million and Orders Restitution of $371,000 for Excessive Markups and Markdowns," November 10, 2011, *supra*; *See also* Researchers at Securities Litigation & Consulting Group found that investors paid $10.6 billion in markups across $2.5 trillion worth of municipal bond trades since 2005, more than half of which were excessive. *See also* Lawrence Harris and Michael Piwowar, Secondary Trading Costs in the Municipal Bond Market, Journal of Finance 61, 1361-1397 (2006), http://bit.ly/1J3owpC; Erik R Sirri, Report on Secondary Market Trading in the Municipal Securities Market, July 2014, http://bit.ly/1xuslwC.

[162] *See, e.g.*, FINRA enforcement actions against David Lerner Associates (excessive markups of collateralized mortgage obligations) *supra*; Press Release, "FINRA Expels APS Financial, Bars Former President and Former Broker for Targeting an Elderly Investor with Fraudulently Excessive Mark-ups," December 29, 2010, http://bit.ly/1ebRrgi (excessive markups in collateralized mortgage obligations and collateralized debt obligations).

securities other than Ginnie Mae have what is widely considered to be an implicit guarantee that the U.S. government will not allow these agencies to default on their obligations. As a result, agency debt securities have minimal credit risk. In addition, there is a large and active secondary market for Treasuries and agency debt securities, which provide investors dependable liquidity.

Theses creditworthiness and liquidity protections would however affect the extent to which the exemption can be used for corporate debt securities transactions. We view this as a feature, not a bug, in the proposal. This is because, while many corporate debt securities trade in highly liquid markets and have a strong likelihood of meeting their financial obligations (and therefore a low likelihood of default), there are also many corporate debt securities that have a substantial credit risk and that are thinly traded, making them extremely difficult to value objectively. Securities that are difficult to value are, in our view, more likely to be securities that an adviser may be attempting to dump on his clients. As such, the potential for abuse rises with the difficulty of determining whether the transaction was fair. The proposal provides important safeguards against these risks by imposing creditworthiness and liquidity constraints.

We recognize that the DOL is limited in several ways in how it approaches a proper framework to gauge a security's credit risk. This is due to the Dodd-Frank requirement to remove all references to credit ratings from all federal statutes and regulations,[163] and financial regulators' failure to create any substantive metrics by which to assess credit risk.[164] We think that the DOL has done the best it can to set an appropriate creditworthiness standard given these inherent limitations.

One question we have is who would be responsible for making these creditworthiness and liquidity determinations. The release cites to the SEC's rule eliminating credit rating references for Business and Industrial Development Companies (BIDCOs),[165] but the context in which creditworthiness and liquidity determinations are made in that environment is different. A BIDCO has a board of directors that is ultimately responsible for those decisions, with the board often delegating the day-to-day decision-making to a fund manager. An adviser who recommends to an investor that she engage in a certain principal trade for a specific security is unlikely to have the financial sophistication and time necessary to conduct a proper credit analysis, short of depending exclusively on credit ratings or the adviser's firm's dictates. We therefore think that it would be helpful to require that the firm have policies and procedures in place detailing how credit risk and liquidity assessments are being made and ensuring that they are based on objective, verifiable standards.

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[163] Dodd-Frank Act Section 939A, Review of Reliance on Ratings.

[164] *See, e.g.,* April 25, 2011 Letter from Dennis Kelleher, CEO of Better Markets, to the SEC, References to Credit Ratings in certain Investment Company Act Rules and Forms, http://bit.ly/1CSw8vW(standards used are "overly vague and must be more detailed and concrete"). *See also* October 14, 2014 letter from Micah Hauptman, Financial Services Counsel of CFA, to the SEC in the money market mutual fund context, http://1.usa.gov/1If88FU; *and also* April 25, 2011 Letter from Barbara Roper, Director of Investor Protection of CFA to the SEC in the money market mutual fund context, http://bit.ly/1HEK1wX (objecting to the elimination of references to credit ratings without providing objective limits on securities that money market funds could invest in, or proving any guidance on the factors, beyond credit ratings, that boards would have to consider in arriving at their assessments of credit risk).

[165] SEC Final Rule, Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption, Release No. IC-30268; File No. S7-07-11, http://1.usa.gov/1HLAban.

Next, regarding the pricing requirements, we strongly support a process that requires an adviser and his firm to articulate not only the reasonableness of a proposed principal transaction but also why a proposed principal transaction is in the retirement investor's best interests relative to available alternatives. With these goals in mind, we support the intent behind the requirements that 1) the adviser and firm reasonably believe that the price at which the security is executed is at least as favorable as a transaction that is not a principal transaction and 2) the price be at least as favorable as prices provided by two ready and willing counterparties.

However, we are concerned that these requirements may not result in executions that are truly advantageous to investors. Regarding the first requirement, it is our understanding that the vast majority of fixed income trading occurs on a principal basis, and therefore there may not be a non-principal transaction price available for comparison. Therefore, we encourage the DOL to consider amending the first requirement to require comparison with transactions on both a principal and non-principal basis. This would help to protect against the risk that firms only execute these trades in their principal capacity and thus escape scrutiny under the first requirement.

Regarding the second requirement, we can envision a scenario in which broker-dealers have a tacit understanding with other firms whereby the firms providing quotes never do better than the initial quote. Any such agreements could be difficult, if not impossible, to detect and more difficult still to prove. If all the firms are executing the transactions in principal capacities, then the first requirement would not act as a backstop protection to the second, and there may be an opportunity for principal trading abuse. Therefore, we encourage the DOL to consider amending the second requirement to require advisers and their firms to cite current market data and articulate why the proposed principal transaction is both reasonable and in the retirement investor's best interests relative to other available alternatives.

Near real-time market data is available on FINRA's TRACE and would provide the basis for assessing the costs and benefits of a proposed transaction. For example, the adviser could examine recent trading of the same security that the adviser recommends executing and, based on that security's recent pricing, propose a price that is fair and reasonable. Assuming no changes have occurred in the market from the time the last trade occurred until the recommendation was made, the proposed price should be extremely close to the last trade price. If there hasn't been recent trading in the same security that the adviser recommends to use as the basis for comparison, the adviser could first find a similar security for which there is a viable price reference, then propose a price based on that reference security. In this instance, the adviser would have an affirmative obligation to prove why the characteristics of the reference security are similar enough to the actual security being transacted such that using the reference security is warranted. We think that forcing an adviser to cite near real-time market data to articulate why the proposed principal transaction is not only reasonable but also why it is in the retirement investors' best interests will offer significant protections against the risk that advisers and firms will recommend and execute principal transactions that are disadvantageous to retirement investors.

Finally, we support the DOL's proposed pre-transaction, confirmation, and annual disclosure. As we've stated previously, disclosure is necessary but it is not sufficient to protect retirement savers from principal trading abuses. It is worth reiterating one technical point with regard to confirmation disclosures. The proposal requires a financial institution to provide a written confirmation of the principal transaction "in accordance with Rule 10b-10 under the Securities and Exchange Act of 1934 that also includes disclosure of the mark-up, mark-down, or other payment to the Adviser, Financial Institution or Affiliate in connection with the Principal Trade." As discussed above, Rule 10b-10 does not require transaction disclosures to be provided on a customer's confirmation if the broker-dealer is acting in its principal capacity, which would likely mean that retirement investors will not receive useful confirmation disclosures.

However, FINRA has recently proposed to require firms to disclose on their customer confirmations the price to the customer, the price to the member of a transaction in the same security, and the differential between those two prices for same-day retail-sized (100 bonds or less or bonds with a face value of $100,000 or less) trades.[166] If adopted, this proposal would effectively require "riskless principal" transaction markups and markdowns to be disclosed. According to FINRA's release, its proposal would capture a significant part of the market. Using data from the third quarter of 2013 for corporate bonds, FINRA has observed that over 60 percent of retail-size customer trades had corresponding principal trades on the same trading day.[167] And so, while not a complete solution, a substantial part of the market would receive useful confirmation disclosures.

Perhaps the DOL could take advantage of FINRA's proposed rules to require heightened confirmation disclosure of pricing information in fixed income securities transactions more generally. The rule could achieve this first by stating that, if the FINRA disclosure rules for same-day trade transactions are finalized, in addition to complying with Rule 10b-10, firms would be required to comply with FINRA's rule where the requirements of the rule are met. Where the requirements of the FINRA rule are not met, they would be required to provide markup and markdown disclosure requirements based on the amount in excess of or reduced from the "prevailing market price," as defined by FINRA Rule 2121 and Supplementary Material .02 thereunder. FINRA's definition of "prevailing market price" should only be used as a fallback option, however, as it allows firms to effectively set the "prevailing market price" they charge or pay for a security in relation to the markup or markdown they charge, thus undermining the purpose of fair and accurate pricing information that these disclosures are supposed to provide.

In sum, we appreciate the DOL's proposed approach, as it does not rely exclusively on disclosure and consent to protect investors' interests and instead incorporates concrete safeguards to prevent principal trading abuses. With a few minor technical adjustments, as discussed above, the rule can create an effective framework for ensuring that principal trades are conducted on terms that are truly in retirement investors' best interests.

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[166] FINRA Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets, FINRA, November 2014, http://bit.ly/1JbS7iN.

[167] *Id.*

V. Conclusion

With this revised rule proposal, the Department of Labor has achieved what many thought to be impossible. It has produced a principles-based rule that strengthens protections for retirement savers but does so in a way that would enable financial firms operating under a variety of business models to comply. The continued opposition of many brokerage, insurance, and mutual fund companies should help to make clear that, too often, these sales-based advisers' claim to support a best interest standard is superficial at best. That support quickly evaporates at the suggestion that they might have to make more than trivial changes to current practices in order to come into compliance.

Those who want to give lip service to support for a best interest standard while maintaining the status quo often argue that securities regulators should take the lead in developing such a standard. There are any number of reasons why this is a ridiculous suggestion on its face. It is DOL, not the SEC or FINRA, that has exclusive authority to write rules implementing ERISA, and only DOL has authority to write rules governing advice to retirement plans. Moreover, while securities play an important role in the retirement market, it is not exclusively a securities market. Insurance also plays an important role, and some of the most troubling abuses relate to other, more exotic investments, such as gold and art. A DOL standard can cover the entire universe of retirement investment advice; a securities-based standard cannot.

Even more fundamental than these jurisdictional questions, however, is the fact that federal securities regulators have an abysmal record of dealing with the complex issues that are the subject of the DOL rulemaking. In the late 1980s and early 1990s, for example, when broker-dealers faced growing competition from financial planners on one side and discount brokers on the other, the SEC and FINRA's precursor, the NASD, showed greater concern for protecting the full service broker-dealer business model than for protecting investors. It was during this era that the agency adopted policies that permitted brokers to rebrand their sales force as advisers, market themselves as advisers, and offer financial planning and other clearly advisory services all while claiming their "solely incidental to" exemption from the Investment Advisers Act. Time and again, NASD argued off of industry's talking points in defending this anti-investor regulatory approach.

For at least 15 years, investor advocates have been urging the SEC to reverse this tide by requiring broker-dealers to comply with a fiduciary standard when providing personalized investment advice. We have identified this as the single most important step the agency could take to improve protections for retail investors. It is only recently that the SEC and FINRA have voiced support for rulemaking, and it is far from clear from their statements on the issue how far they are willing to go to deliver the protections investors want and need. For example, despite external and staff studies supporting rulemaking, a clear authorization from Congress in the Dodd-Frank Act, and statements of support from the current and two preceding SEC chairs, the agency still has not produced a rule proposal, let alone a final rule, and cannot count on broad support among the commissioners for rulemaking. The best interest standard outlined by FINRA

in its comment letter and in an earlier speech by CEO Rick Ketchum (discussed in greater detail below) is missing crucial components of a comprehensive, pro-investor standard.

The SEC's failure to adopt a fiduciary standard for brokers when they provide investment advice is symptomatic of its broader failure to adopt strong protections for retail investors. Indeed, even where a fiduciary duty applies under the Investment Advisers Act, the agency shows little inclination to enforce it effectively. Under the Commission's approach to enforcement, the best interest obligation is rarely brought to bear, and conflicts are almost always handled through disclosure rather than more meaningful mitigation. It appears that it is precisely this toothless enforcement that industry has in mind when it purports to embrace a best interest standard. And it is this poor enforcement of the fiduciary standard FINRA appears to be referring to when it suggests that DOL's proposed best interest standard "differs significantly from the fiduciary standard applicable to investment advisers registered under the federal and state securities laws."[168]

The SEC's record regarding regulation of conflicts of interest is no better. Despite years of entreaties from investor advocates, the agency has done nothing to rein in even the most egregious of the conflicts of interest that pervade the brokerage industry. Five years after the Dodd-Frank Act mandated that the agency examine compensation practices and conflicts of interest among broker-dealers and investment advisers, the agency has shown no sign of undertaking any such study, let alone acting on the Dodd-Frank Act's authorization to "promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors." FINRA, which has at least studied the issue, has offered nothing but voluntary "best practice" guidance in response.

Even with regard to disclosures -- the "solution" regulators so often offer when they are unwilling to take more meaningful action -- the SEC's record of inaction is the same. Here again, investor advocates have been pushing for pre-engagement disclosures for brokers and pre-sale disclosures of key information, including costs and conflicts, for investment products for close to two decades. Although the SEC issued a proposal for point-of-sale mutual fund disclosure in the early years of the previous administration, it was withdrawn in the face of industry opposition. A proposal to reform 12b-1 fees suffered a similar fate when industry raised objections. Language in the Dodd-Frank Act mandating a pre-engagement disclosure document for brokers and authorizing pre-sale disclosures for investment products have produced nothing in the way of concrete proposals, despite a staff study showing a clear investor preference for pre-engagement and pre-sale disclosure.

Finally, while the Dodd-Frank Act authorized the SEC to adopt rules to ban or restrict the use of pre-dispute binding arbitration clauses in brokerage contracts, the agency has failed to act on this authority. Had the agency acted, the Department might have had options other than

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[168] July 17, 2015 letter from Marcia E. Asquith, Senior Vice President and Corporate Secretary, to the Office of Regulations and Interpretations and the Office of Exemptions Determinations, Employee Benefits Security Administration, Department of Labor, regarding "*Proposed Conflict of Interest Rule and Related Proposals,*" RIN-1210-AB32.

permitting such clauses in the BIC. Investors would have been better served by an approach that preserved their full range of options for resolving disputes.

There is no question that DOL's job in drafting this rule would have been easier had securities regulators provided a strong model for the Department to follow. Unfortunately, on issue after issue over the years, federal securities regulators have either backed down in the face of industry pressure or sided with industry and against investor advocates regarding the need for reform. This same tendency has been very much in evidence in FINRA's response to the DOL fiduciary rule proposal, including both remarks delivered by FINRA CEO Rick Ketchum[169] and FINRA's recently filed comment letter on the rule proposal. Both echo inaccurate industry claims regarding the confusion that investors would suffer if the DOL adopted a standard that differed from securities law standards and the threat that industry might desert this market if forced to comply. Indeed, the speech and the comment letter taken together call into question FINRA's oft repeated support for a fiduciary standard that is at least as robust as the standard articulated in the Dodd-Frank Act. And both offer the existing securities standards that investor advocates have found so abysmally inadequate as the model that DOL should follow in adopting rules under ERISA.

FINRA starts by suggesting that a "fractured approach," in which DOL applies a different standard under ERISA than applies under securities laws, "will confuse retirement investors, financial institutions, and advisers."[170] In assessing the validity of this concern, it is important to note that an investor who does business with a broker-dealer today might simultaneously have a commission account, where recommendations are subject to a suitability standard, a fee-based account, where recommendations are subject to an Advisers Act fiduciary duty, and a self-directed account, where no duty applies as no advice is rendered. That same investor might purchase insurance products through that adviser in his or her capacity as an insurance agent under a different standard still. FINRA expresses no concern that investors (or financial institutions or advisers) might be confused about the duty that applies to a particular conversation between the investor and his adviser under this array of standards. It is only DOL's proposal to adopt a fiduciary standard under ERISA, apparently, that creates unacceptable confusion.

FINRA's critique ignores the fact that Congress intentionally set a higher standard under ERISA for investment advice to tax-advantaged retirement accounts than the standard it set under securities laws. These higher standards are justified to ensure that tax subsidies are not siphoned off by conflicted advisers giving self-serving advice. FINRA's critique also ignores the much more damaging confusion that would arise if different standards applied to recommendations regarding different types of investments within retirement accounts. But that is the inevitable result of prioritizing a consistent set of standards across different types of accounts over a consistent standard for all products sold within retirement accounts. Of course,

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[169] "Remarks From the 2015 FINRA Annual Conference," by Richard G. Ketchum, FINRA Chairman and Chief Executive Officer, May 27, 2015, http://bit.ly/1If97FQ.

[170] July 17, 2015 letter from Marcia E. Asquith, Senior Vice President and Corporate Secretary, to the Office of Regulations and Interpretations and the Office of Exemptions Determinations, Employee Benefits Security Administration, Department of Labor, regarding "*Proposed Conflict of Interest Rule and Related Proposals,*" RIN-1210-AB32.

the real confusion arises from the fact that investors already assume they are receiving fiduciary advice. Securities regulators have done nothing to address that problem in the 15 years that advocates have called for reform. With its proposal to adopt a securities law solution to an ERISA problem, FINRA has nothing to suggest to address this confusion except a call to keep waiting in the hopes that securities regulators will finally find the wherewithal to act.

Those who still hope, as we do, that securities regulators *will* ultimately act to adopt a fiduciary standard for brokers -- as a supplement to and not a substitute for DOL action -- should draw little comfort from FINRA's description of the key elements of such a duty. Here again, FINRA echoes industry talking points when it calls for a "best interest" standard that is not only weaker than the standard proposed by DOL, but weaker than the standard mandated by Congress in Section 913 of the Dodd-Frank Act. Specifically, FINRA's proposed standard (like the standard proposed by SIFMA) would not include the crucial component that advice be delivered "without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."

In a bizarrely twisted argument, even as it calls for a common standard for all securities accounts, FINRA uses SEC's failure to act under its Dodd-Frank authority to argue against DOL's adoption of this same standard for investment advice under ERISA. Its comment letter states: "This principle, borrowed from Section 913 of Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), has not been developed under ERISA or the federal securities laws and financial institutions, their advisers and their compliance officers and counsel will be forced to anticipate its intended meaning. ... Since financial institutions and advisers are engaged in a business that will earn compensation for their services, they would not provide investment advice at all if the customer were unwilling to pay the fee. Surely this is not the Department's intent." This is an obtuse reading of the rule proposal, and the Dodd-Frank language, raising serious questions about FINRA's appetite and ability to effectively enforce any fiduciary standard, whether adopted under ERISA or under Section 913 of the Dodd-Frank Act.[171]

The FINRA comment letter is replete with similar examples of FINRA's defense of the status quo. Perhaps most glaring is its proposed treatment of differential compensation. As discussed above, this is the conflict at the heart of the broker-dealer business model that most directly encourages brokers to make recommendations that serve their own financial interests rather than those of their clients. While FINRA purports to support a fiduciary duty that requires brokers to "eliminate conflicts whenever possible," it specifically mentions differential compensation as a conflict that should instead be addressed through "written supervisory procedures" designed to ensure that compensation differences don't affect recommendations. But FINRA itself has argued elsewhere that it "is unclear how a financial institution or adviser would demonstrate that the amount of compensation was *not* a factor in the recommendation." Presumably, it would be equally difficult to prove that it *was* a factor. In short, this is a prescription for maintaining harmful current practices, in which firms are permitted to reward advisers financially for advice that is not in their customers' best interest, all while giving lip service to a best interest standard that reluctant regulators are unlikely to enforce.

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[171] Ketchum made a similar argument in his earlier speech, in which he called into question FINRA arbitrators' ability to resolve claims based on this standard.

The message that comes through in both the Ketchum speech and the FINRA comment letter is that FINRA disputes the implication in the Council of Economic Advisers study, the DOL's regulatory impact analysis, and the rule proposal itself that the SEC and FINRA's current regulatory approach is fundamentally inadequate and exposes retirement savers to harm. This lack of complacency about the status quo is, of course, precisely what investor advocates find so refreshing in the DOL's proposal. Indeed, the beauty of the Department's proposed approach, in our view, is precisely this: that it recognizes that imposing a best interest standard without also requiring changes to practices that encourage and reward advice that is *not* in the customer's interest is unlikely to deliver meaningful new protections to retirement savers.

Retirement savers who are struggling to fund an independent and secure retirement need financial advice they can trust. Today, neither our securities regulations nor the rules under ERISA provide that assurance. Instead, both sets of regulations expose retirement savers to self-serving recommendations from conflicted advisers who are free to recommend products based on their own financial interests rather than those of their customers. The DOL proposal -- which combines a best interest standard with meaningful restrictions on the practices that undermine that standard -- offers significant progress toward addressing this problem. We can only hope that the SEC will eventually follow the Department's lead and craft a similarly strong and effective rule for non-retirement accounts. But in a nation that faces a retirement crisis, and with DOL ready to act, we cannot afford to wait. We therefore urge you to move forward without further delay to adopt a final rule based on the eminently sound regulatory approach proposed here.

Respectfully submitted,

Barbara Roper

Barbara Roper
Director of Investor Protection

Micah Hauptman

Micah Hauptman
Financial Services Counsel

Appendix B: Testimony of CFA Director of Investor Barbara Roper
At DOL Hearings on Conflict of Interest Rule

Consumer Federation of America

Statement of CFA Director of Investor Protection Barbara Roper
In Support of the Department of Labor's Conflict of Interest Rule

(Delivered at the Public Hearing August 10, 2015)

As you enter this next phase of the rulemaking process, you all face the unenviable prospect of digging through thousands of pages of comments that have been submitted in response to this rule to find the relatively few valuable nuggets – genuine suggestions to improve the rule – buried within this huge pile of verbiage. The good news is that those nuggets are there. Concrete suggestions have been submitted to improve the rule, whether by clarifying key points or making it easier to implement, that can and should win support from a broad range of stakeholders in this debate. But I'd like to focus today on a few issues that we believe you can safely ignore as the last gasp efforts of industry to maintain a status quo that has been hugely profitable for them, but far less beneficial for the working families and retirees who struggle to afford a secure and independent retirement.

1) The first is the argument that industry supports a best interest standard, just not the apparently fatally flawed best interest standard you've put forward here.

I'd be prepared to make a small wager that virtually every industry representative who testifies here this week will, at some point in their remarks, profess their support for a best interest standard. Some of them may even mean it. But when you look at the details of the standard they actually support, you will find that in the vast majority of cases, there is considerably less there than meets the eye.

So, for example, they will be happy to support a best interest standard as long as it doesn't cover the full range of services that retirement investors perceive and rely on as objective investment advice. Toward this end, they argue for broad new exemptions – an expansion of the seller's carve-out to the retail market is a popular one – that would have the effect of recreating using different words precisely those loopholes this rule was intended to close.

Or they will support a best interest standard as long as no one actually expects them to seek to do what is best for the customer. You know, I've been doing this for a long time, but I was frankly shocked to see FINRA make this argument in its comment letter, in which they basically

suggested that "best interest advice" and "suitable advice" are really just two different names for essentially the same thing. I can assure you that that's not how investors see it.

Or, and this is absolutely crucial, industry groups will be happy to support a best interest standard as long as no one expects them to set aside their own financial interests as they seek to determine the best course of action for the customer, as long as they don't have to dismantle the complex web of financial incentives they've created to pay and reward their advisers for advice that is not in the customer's best interest.

In short, they support a best interest standard as long as it doesn't require them to do what is best or to make any meaningful changes in the way they do business today.

The Department's standard, which recognizes that best interest should set a higher bar than suitability and which backs that standard with real, meaningful mitigation of conflicts is absolutely consistent with the reasonable expectations of retirement savers when they turn to financial professionals for advice. It is industry's best interest standard in name only that is fatally flawed.

2) The second argument that we would encourage you to ignore is that argument that the Department should step aside and let securities regulators take the lead in order to avoid the confusion that could arise if different accounts were subject to different standards.

There are so many holes in this argument it would be impossible to catalog them all in the time available here today. But, it is worth noting that, if the SEC were eventually to get around to adopting a rule – something that is far from guaranteed, at CFA we've been waiting for a little over 15 years – it would by definition be limited to recommendations regarding securities. It would not apply to recommendations of insurance products, which form a pretty important part of the retirement market, or other non-securities investment that are sold to investors through retirement accounts. The result would be a single standard for all securities accounts, which would admittedly ease compliance for broker-dealers, at the expense of different standards for different products sold *within* retirement accounts, which would be far more confusing for retirement savers and expose them to greater risks.

The irony here is that the Department has gone out of its way to incorporate securities law principles as it was crafting this rule. Your definition of investment advice is virtually identical to the securities law definition. Your best interest standard is borrowed directly from Section 913 of Dodd-Frank, where Congress identified this "best interests, without regard to the financial or other interests of the adviser" as the standard that should apply if the SEC were to adopt rules under the securities laws. You even deal with issues related to ongoing duty of care and sales from a limited menu of proprietary products in ways that are consistent with the principles in Dodd-Frank. Indeed, the SEC could do far worse than to follow the Department's lead if it does eventually get around to drafting a fiduciary rule for the securities markets.

There is no doubt that the Department's job would have been easier if the SEC had provided leadership – if it had adopted a strong fiduciary standard for brokers, if it had taken steps to rein in the toxic conflicts that pervade the broker-dealer business model, or if it had even just adopted clear disclosures regarding the costs and conflicts associated with that advice. But it has done none of those things despite decades of entreaties from investor advocates. All of which leads me to wonder whether the real reason industry lobbies so enthusiastically for securities regulators to take the lead on this issue is that they know this is a good way to ensure that nothing ever happens, or else believe that they have a far better chance of getting the watered down standard they've been lobbying for if securities regulators write the rule.

We don't know at this point where the SEC will ultimately come out on this issue, and we hope for better things. But when you listen to the noises that have been coming out of FINRA lately and from one particularly vocal SEC commissioner, industry has good reason to believe their prospects for a watered down standard from securities regulators are pretty good.

3) I would be remiss if I didn't mention here industry's favorite argument against the rule – that many brokers will simply stop serving this market if the rule is adopted and that investors, particularly small savers, will be harmed if they lose access to advice or are forced into more expensive fee accounts.

Here again, there are many holes in this argument, not least that there is actually no compelling evidence that commission-based brokerage accounts are consistently more affordable than fee accounts when the total cost of investing are taken into account. But the more fundamental point you need to keep in mind is that this is what they always say when faced with a rule they don't like.

A recent example arose when the SEC was considering whether to regulate all fee-based accounts as advisory accounts under the Investment Advisers Act. Many of these same organizations, indeed some of the same individuals, made exactly the same arguments they've made here, that brokers would be forced to stop offering the accounts and investors would lose access to valued services, if the accounts were regulated as advisory accounts. The SEC backed down, but, in a rare win for investors, its decision was overturned in court. As a result, all fee based accounts today are regulated as advisory accounts. And, guess what? The sky didn't fall. Brokers didn't stop offering the accounts. On the contrary, there's more money in fee-based accounts at broker-dealers today than ever before.

So, while there are good reasons as you finalize the rule to seek to make it as streamlined and easy to implement as possible consistent with a strong and effective rule, there is absolutely no reason to believe that financial firms are going to voluntarily walk away from a multi-trillion-dollar market if you finalize a rule based on this proposal.

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I'd like to conclude by noting that we have a retirement market today that works really, really well for the broker-dealers, and insurance companies, and mutual fund companies that reap billions of dollars in profits providing services to our tax-subsidized retirement accounts. But it works a lot less well for working families and retirees – individuals with no particular financial sophistication – who struggle with complex decisions about how best to save and invest for and in retirement, and who bear the full risks when those decisions turn out badly. This rule can help to ensure that, when they turn to financial professionals for investment advice, they actually get real, objective advice and not just a sales pitch dressed up as advice. That won't solve every problem with our retirement system, but it is a goal very much worth fighting for. So we urge you to move forward without further delay to finalize this rule and we look forward to working with you to achieve that goal.

Thank you.

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Consumer Federation of America (CFA) is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

Appendix C: CFA, Better Markets, Americans for Financial Reform Analysis
Of Fidelity Investments' "New Best Interest Paradigm"

Fidelity's 'New Best Interest Paradigm' Does Not Serve the Best Interests of America's Working Families and Retirees

In its comment on the Department of Labor's conflict of interest rule proposal, Fidelity Investments has offered an "alternative" approach that it describes as a simpler means of achieving the same ends. In reality, the Fidelity alternative fails to deliver meaningful new protections for workers and retirees who turn to financial professionals for retirement investment advice. As such, it is unacceptable as an alternative to the DOL rule proposal and unworkable for retirement savers.

Fidelity's "new best interest paradigm" suffers from three fatal flaws:

- It fails to apply a best interest standard to the full range of services perceived and relied on as fiduciary investment advice by retirement savers.
- It allows certain rollover and pension benefit withdrawal recommendations to be made without regard to the best interests of the retirement saver.
- It fails to take meaningful steps to curb industry practices that encourage advice that is not in the best interest of the retirement saver.

Fidelity's Alternative Fails to Subject All Investment Advice to a Fiduciary Standard

One of the key strengths of the DOL rule proposal is that it closes loopholes in the definition of investment advice that have for too long enabled financial firms to provide services that are perceived and relied on by retirement savers as objective advice without having to act in the best interests of those customers. Those loopholes have left working families and retirees without the protections of a fiduciary standard precisely when the conflicts of interest associated with the advice are most intense and the risks to the investor are greatest.

Fidelity's proposed approach would reopen those loopholes through the combined effect of two seemingly innocuous provisions. First, Fidelity proposes to limit fiduciary protections to situations in which the advice recipient has "a reasonable expectation" that he or she can rely on the advice as "unbiased and in the recipient's best interests." Second, firms would be permitted to dictate the scope and terms of the relationship through a pre-engagement contract negotiated outside the fiduciary standard. If this approach were adopted, firms could simply dictate as part of the contract that the advice is not unbiased to evade their fiduciary duty, just as they use fine print legal disclaimers today to achieve the same result. Consider this example of such a disclaimer, which is ubiquitous in Fidelity's retirement materials and is typical of those firms currently use to evade their fiduciary duty: "Guidance provided by Fidelity is educational in nature, is not individualized and is not intended to serve as the primary or sole basis for your investment or tax-planning decisions."

Fidelity's Alternative Would Create a New Loophole for Rollover Recommendations

One of the chief ways that financial firms take advantage of retirement savers is by encouraging them to roll money out of their 401(k) or pension and into higher cost or riskier

investments in an IRA. But higher costs can over the years seriously erode workers' retirement savings. The DOL rule would address this problem by requiring that recommendations with regard to rollovers from defined contribution plans and withdrawals from defined benefit pension plans be based on the customer's best interest. In contrast, Fidelity's proposed approach would continue to allow financial firms to make rollover and benefit withdrawal recommendations without regard to the best interests of the customer as long as they do not include specific investment recommendations.

Under Fidelity's proposed approach, all firms would have to do to evade their fiduciary duty to put the customer first would be to separate the recommendation regarding *whether* to take a benefit withdrawal or rollover from specific recommendations regarding *how* to invest the proceeds. So, for example, a firm could recommend that a federal employee roll money out of the Thrift Savings Plan without having to consider whether that move was in the individual's best interests. If the employee decided to follow that non-fiduciary advice, any best interest obligation would apply only to recommendations of how to invest the proceeds based on the available investment options. The adviser would not be required to recommend investments that are better for the investor than those in the TSP they convinced them to leave. This would leave retirement savers vulnerable to self-interested and costly advice when making one of the most important financial decisions of their lives.

If this approach were adopted, financial firms would benefit, as their ability to syphon funds out of workplace retirement plans could continue virtually unimpeded. Meanwhile, retirement savers who turn to financial professionals for help navigating these decisions would have no assurance that the recommendation they receive to leave the relatively protected environment of the 401(k) plan or to forego the guaranteed monthly payments for life of a traditional pension plan is designed to serve their financial interests rather than those of the advice provider.

Fidelity's Alternative Fails to Rein in Practices that Conflict with Customer Interests

In developing its rule, the DOL rightly concluded that, to be effective, a best interest standard must be backed by meaningful constraints on common industry practices that work against that goal. As such, the DOL rule proposal would require financial firms to abandon current industry practices that compensate and reward advisers for recommendations that are not consistent with customers' best interests. Such practices include setting quotas for the sale of proprietary products and basing bonuses or payouts on the adviser's success in meeting those quotas, rewarding advisers with vacation trips for high volume of sales, or paying advisers significantly more to sell higher risk investments or investments that make revenue sharing payments.

Fidelity's new best interest paradigm includes no restrictions on such practices. Instead, Fidelity's alternative relies exclusively on disclosure to address conflicts of interest. But extensive academic research has shown that conflict disclosures are ineffective in protecting investors from the harmful consequences of conflicts and may, in some cases, actually do more harm than good. For retirement savers to reap the full benefits of a best interest standard, firms must be required to dismantle the complex web of toxic incentives that work against that goal.

* * *

More than ever before, working families and retirees bear the full brunt of responsibility and risk associated with saving for an independent and secure retirement. When they turn to financial professionals for advice to help them navigate those complex issues, they deserve objective advice, and not just a sales pitch dressed up as advice. Because it would make it too easy for firms to evade their fiduciary obligations and would do too little to rein in harmful practices that exacerbate sales-related conflicts, Fidelity's "new best interest paradigm" fails to provide that assurance.

Appendix D: CFA's Statement on SIFMA's Proposed Best Interest Customer Standard

Consumer Federation of America

For Immediate Release
June 3, 2015

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CFA Statement on SIFMA's Proposed Best Interests of Customer Standard for Broker-Dealers

Washington, D.C. – The Securities Industry and Financial Markets Association (SIFMA), the self-described "voice of the U.S. securities industry," has offered what appears to be intended as a proposed alternative to, or model for, the Department of Labor's Conflict of Interest rulemaking. If SIFMA's intent was to offer an alternative to the DOL proposal, it has failed. Even on its own terms, as a proposal to strengthen securities law protections, it falls well short of what is needed.

The SIFMA proposal would be "articulated…through amendments to existing FINRA Rules, as approved by the SEC." Furthermore, the proposal appears to subjugate the DOL's authority to update rules under the Employee Retirement Income Security Act (ERISA) to FINRA's and the SEC's regulatory authority under the securities laws. According to the proposal, "Any consideration by the DOL to adopt a best interests standard should be consistent with a prospective FINRA/SEC standard."

SIFMA's proposal should in no way be viewed as a substitute for DOL rulemaking. FINRA and the SEC have authority only over securities markets, and therefore SIFMA's proposal would not cover investment advice regarding non-securities within retirement accounts. As a result, SIFMA's proposal would not apply to retirement investment advice relating to insurance products, which are a major component of the retirement market and are often subject to significant sales-driven conflicts of interest. Nor would it address egregious abuses involving sales of art, gold, and other products to retirement investors. SIFMA's proposal also would apply only to retail accounts, and therefore not cover investment advice provided to employer retirement plans.

As we have said repeatedly, a comprehensive solution to the conflicted investment advice problem requires action by both the DOL and the SEC. In the securities context, the proposal that SIFMA has offered could be an important supplement to the DOL proposal if it were significantly strengthened in key ways. Specifically, the proposal would need to be less reliant on the disclosure and consent to material conflicts of interest, and more specific in how compensation practices and other incentives that encourage advisers to act in ways that are inconsistent with their customers' best interests would be reined in. In this regard, SIFMA's proposal is weak and vague precisely where the DOL's proposal is strong and clear.

Offering a securities law alternative to the DOL proposal is woefully insufficient, as it will not comprehensively protect retirement savers from conflicted investment advice. Offering a securities law proposal that does not even adequately protect retail securities investors from conflicted investment advice renders SIFMA's framework severely deficient standing alone.

It is clear that SIFMA's first priority is to obstruct, obfuscate, delay, and ultimately kill the DOL rulemaking. We think a better approach would be to work constructively within the context of the DOL rulemaking.

Appendix E: CFA Fact Sheets Rebutting Common Industry Arguments in Opposition to the Rule

Consumer Federation of America

DOL Delivers on its Promise: Conflict of Interest Rule Proposal Provides Needed Protections for Retirement Savers, Flexibility for Financial Firms

In mid-April, the Department of Labor did what many thought to be impossible: it issued a proposed rule that strengthens protections for retirement savers by requiring all financial professionals to put the interests of their customers first, but does so in a way that enables financial professionals who are compensated through sales commissions to comply. By simultaneously closing loopholes in the definition of investment advice under the Employee Retirement Income Security Act (ERISA) and permitting the receipt of sales-based compensation subject to certain conditions, the revised rule proposal effectively addresses the concerns raised by industry regarding the original 2010 proposal while enhancing its investor protection benefits. With the revised rule now out for public comment, this document is designed to answer some of the key questions that have been raised.

How are retirement savers being harmed under the current regulatory approach?

American workers and retirees are more dependent than ever on financial professionals to help them navigate the complex decisions they must make to fund a secure and independent retirement. Unfortunately, because of loopholes in rules specifying who is a "fiduciary" under ERISA, many of the financial professionals that retirement savers rely on for advice are free to put their own financial interests ahead of the interests of their customers. While many of these professionals nonetheless seek to do what is best for their customers, others take advantage of gaps in the regulations to steer their clients into high-cost, substandard investments that pay the adviser well but eat away at retirement savers' nest eggs over time. This is a particular problem for small savers – including many women and people of color – who are disproportionately likely to be served by non-fiduciary advisers and to receive conflicted advice. Stemming the tide of financial losses attributable to conflicted advice, as this rule seeks to do, is a concrete step that we can and should take to address our nation's retirement savings crisis.

What is the extent of the harm to retirement savers?

The cost to retirement savers of conflicted advice is enormous. Working from a wide range of independent studies, DOL estimates that investors will lose somewhere between $210 billion and $430 billion over 10 years, and between $500 billion and $1 trillion over 20 years, as a result of conflicted advice just with regard to mutual fund investments in Individual Retirement Accounts (IRAs). Furthermore, a retirement saver who moves money out of a 401(k) plan and into an IRA based on conflicted advice can expect to lose 12 to 24 percent of the value of his or her savings over 30 years, according to the DOL analysis. Overwhelming evidence from a wide variety of sources supports the conclusion that these losses are the direct result of financial advisers' freedom to place their own financial interests ahead of the interests of their customers when offering retirement investment advice.

DOL details the basis for these estimates, and broader conclusions about the harmful impact of conflicts of interest, in a comprehensive Regulatory Impact Analysis (RIA) issued at the same time as the revised rule proposal. As DOL explains in the RIA, it chose to focus on mutual fund investments in IRAs to quantify the harm, not because this is an area considered to be particularly prone to abuse, but rather because it is where the best data is available. If data were available to support an estimate of the cost to retirement savers of all aspects of conflicted advice, the total would likely be significantly higher.

How does the rule fix that problem?

The revised rule proposal closes loopholes in the definition of investment advice, so that anyone who provides individualized investment recommendations to retirement savers would be covered by ERISA's fiduciary duty. As fiduciaries, they could no longer legally put their own financial interests ahead of the interests of their customers. The rule proposal covers advice to traditional and defined contribution pension plans, such as 401(k) plans, as well as advice to plan participants and to those who save through Individual Retirement Accounts. In an important improvement over the 2010 proposal, it covers advice about recommendations to roll money out of a pension or 401(k) plan and into an IRA. This is the most important financial decision many people will ever make, with a potential to seriously affect their standard of living in retirement, and it is an area of well documented abuses.

I've heard the rule would make it impossible for broker-dealers, insurance agents and others who charge sales fees to offer retirement investment advice. Is that true?

No. One of the most significant enhancements in the revised rule proposal is the addition of an exemption that spells out the terms under which financial firms and their advisers can receive sales-based compensation and still comply with the ERISA fiduciary standard. Known as the "best interest contract exemption," this provision ensures that broker-dealers, insurance agents, and others who are compensated through commissions and other forms of sales fees will continue to be able to offer retirement investment advice to both small savers and small plans. As such, it preserves the ability of retirement savers to choose how they prefer to pay for retirement advice without requiring them to give up their right to best interest recommendations when they choose to pay through sales fees.

Won't permitting advisers to earn sales fees put retirement savers at risk?

Some have suggested that the only acceptable approach is to continue to ban all sales-related compensation. This view ignores the reality that all forms of compensation involve conflicts and that investors sometimes have sound reasons for preferring to pay for advice through sales fees. It also ignores the strong protections for investors included in the "best interest contract exemption." First, the exemption for sales-based compensation only applies to advice regarding a range of investments that are appropriate for retirement accounts. Both the firm and the adviser providing the retirement advice would be required to enter into a contract with the advice recipient stipulating that they will provide advice under a fiduciary standard and make recommendations that an impartial expert would view as serving the best interests of the retirement saver. The fees charged for that advice would have to be reasonable. Advisers would

also be required to provide retirement savers with point-of-sale and on-going disclosures regarding the costs and conflicts associated with the advice.

In perhaps its most significant provision, firms that rely on the exemption would be required to take meaningful steps to eliminate practices that could encourage their advisers to make recommendations that do not serve the best interests of the customer. For example, while firms would remain free to recommend in-house products, they could no longer set quotas for the sale of such products and base advisers' bonuses on their success in meeting those quotas. Similarly, while firms would be free to pay their advisers more to sell certain investments, those differential payments would have to be based on objective factors, such as the amount of time necessary to research and implement the investment strategy, and not just on a desire to promote sales of particular investments. This has the potential to dramatically reduce harmful business practices associated with sales-based compensation.

Together, these rule provisions should limit the potentially harmful impact of compensation-related conflicts of interest while providing the benefits of investor choice.

I've heard that small savers could lose access to valued services if rule is adopted. Is this true?

The argument that small savers would lose access to advice was based primarily on the assumption that the rule would prevent advisers from earning sales commissions. That concern, always exaggerated, has been fully addressed through the proposal of the best interest contract exemption for sales-based advisers. Some have made a similar argument with regard to compliance costs and litigation risks posed by fiduciary status. But investment advisers who currently serve small savers have shown that it is possible to serve this market profitably under a fiduciary standard.

The only remaining question is whether certain firms will decide that it is simply not financially beneficial for them to serve small savers if they are no longer allowed to profit unfairly at their expense. We believe most firms will choose to continue to serve this market. However, should some abandon the field, other market participants are ready, willing, and able to step in and offer high-quality, low cost advice to these individuals. As the RIA explains, this is an evolving market. In addition to the traditional advisers who already serve this market under a fiduciary standard, so-called "robo-advisers" – service providers that utilize technology to meet the core portfolio management needs of mass retail investors – and products such as target date funds "minimize the need for complex advice [and] are already rapidly gaining market share. Going forward, they promise to make advice far more affordable for small investors, especially young investors who generally are more accustomed to technology-based tools. More traditional advisory firms are scrambling to develop, partner with, or acquire such innovative tools, and to combine these with more traditional services to deliver tailored services to more market segments at far lower cost than that historically associated with traditional approaches alone." This latter development has the potential to deliver the cost savings associated with the robo-adviser model to an even broader swath of the public.

How will the rule benefit small savers?

Far from being harmed, those with modest incomes and low dollar balances in their retirement accounts stand to benefit most from the proposed rule. Because they are disproportionately served by broker-dealers and insurance agents who are not currently required to serve their customers' best interests, small savers are at greatest risk of receiving conflicted advice that drains their retirement savings. This is money that these individuals desperately need if they are to afford an independent and secure retirement. The revised rule offers these small account holders the flexibility of paying for retirement advice through commissions and other sales fees without forcing them to give up their right to best interest recommendations. As such, it would provide them with the same protections that the typically wealthier investors who invest through fee-based advisers already receive under the securities laws.

All savers should receive an additional indirect benefit from the rule's potential to encourage competition among investment products based on the best interests of the customer rather than compensation to the adviser. Promoting market competition on terms that benefit, rather than harm, advice recipients can be expected to drive down costs to all retirement savers.

I've heard the rule would put small firms out of business. Is that true?

While firms of all sizes will have to adjust their business practices to comply with the rule, there is no valid basis for the claim that small firms would be put out of business. For small firms, the key to compliance will be the initial selection of the product menu they offer to retirement savers to ensure that it comports with a best interest standard. Firms that already offer a mix of reasonably priced, high quality investment options that allows for creation of a diversified portfolio should see relatively little impact from the rule. They would have to enter into a contract with clients, make best interest recommendations, and provide disclosures with regard to costs and conflicts, but their business could otherwise continue largely unchanged. Those whose business is built around the sale of a few high-cost, low-quality products will face a more significant change to come into compliance, but that is appropriate. Either the sponsors of the investment products they recommend will have to adjust their products to make them more competitive under a best interest standard, or the firm will have to consider changing its product mix or, in the case of high-cost products, rebating fees that don't meet the reasonableness standard. While firms are likely to see some increase in compliance cost, including the cost associated with new disclosures, investment advisers who serve the small saver market under a fiduciary standard have shown that it is possible to serve this market affordably.

Won't the rule increase advisers' liability costs?

Some have suggested that the rule would leave advisers vulnerable to lawsuits anytime their customers lose money on an investment or make less than they could have if they had invested differently. This is patently absurd. The rule makes clear that recommendations are assessed for compliance with the best interest standard based on the circumstances prevailing at the time of the recommendation and not on the outcome of that recommendation. As a result, an individual who sought to bring a case on the flimsy grounds cited above would be unlikely to find an attorney willing to represent them. Another significant limitation on firms' liability exposure is the inclusion of language in the rule reaffirming existing FINRA policy with regard to arbitration of claims. Under the rule, firms would still be permitted to include pre-dispute

binding arbitration clauses in their contracts but not to force customers to sign away their right to participate in class action lawsuits, just as they are today. As a result, the vast majority of claims would be heard in the industry-run arbitration forum rather than in court.

Other features of the rule are likely to reduce firms' liability risks. As FINRA CEO Rick Ketchum recently stated in a letter to members, firms actually reduce their regulatory risk when they put their customers' interest first and alleviate conflicts. By requiring firms to take concrete steps to eliminate practices that encourage bad conduct, the DOL rule proposal achieves what FINRA only suggests. As a result, firms that take seriously their obligation to mitigate conflicts and put the interests of customers first should see their liability risks reduced as a result of the better outcomes they achieve for clients. The threat of litigation should therefore serve to encourage compliance without raising the specter of excessive liability exposure.

Will the rule prohibit sales of in-house products?

No. The rule permits the sale of in-house products subject to the conditions of the "best interest contract exemption." If an impartial expert would deem the in-house product to be in the best interest of the investor and if the fees are reasonable, advisers would be free to recommend them to retirement savers. In-house products that already meet these standards would therefore be unaffected by the rule. Those that don't currently meet these standards would have to adjust or risk losing market share.

Where a firm's product menu consists entirely of a limited menu of in-house products, additional requirements would apply. In such circumstances, the firm would have to make a written finding that the limitations do not prevent the adviser from providing advice that is in the best interest of the retirement investors. Payments received for the services could not exceed the fair market value of the services provided, a more specific determination than is required under the best interest contract exemption's reasonable fees requirement. Before making recommendations, the firm would have to provide clear notice of any limitations placed by the firm on the investments offered by the adviser. And the adviser would have to notify the customer if their product menu did not include options that meet that individual's needs. These are reasonable precautions to address the particular risks associated with this business model.

Will the rule prohibit sales of annuities?

No. Annuities are on the list of products advisers would be free to recommend under the terms of the best interest contract exemption. Where an annuity is in the best interest of the retirement saver and the costs are reasonable, the adviser who otherwise complies with the terms of the best interest contract exemption would be free to recommend that annuity. Sales outside of retirement accounts, which is where one would expect the bulk of variable annuity sales to occur, would also be unaffected.

Will mutual fund companies and financial firms still be able to offer investor education materials without being regulated as fiduciaries?

Yes. The rule draws a clear distinction between advice, which is subject to a fiduciary duty, and investor education, which is not. The key distinction is whether the information includes a specific investment recommendation that the retirement saver can reasonably be

expected to act upon, in which case it is regulated as advice and subject to a fiduciary duty. As long as an adviser is providing general information and not a specific investment recommendation, the provision of information will not be treated as fiduciary advice under the rule. That is true regardless of who provides the information or the form in which the information and materials are provided.

Will the rule put call centers out of business?

Firms that use call centers to provide routine account services and investor education would be unaffected by the rule. There are clear carve-outs for both types of activities in the definition of investment advice. The rule would only affect call center operations in the narrower circumstances that call center personnel actually offer investment advice. In those cases, the call centers would have to adjust their practices to comply with the best interest contract exemption, but even so there is no basis for the concern that they would be put out of business.

There is good reason, moreover, to ensure that investment advice offered through call centers is covered by the rule. A 2013 report by the Government Accountability Office (GAO) provides alarming evidence of the tactics that call centers engage in to encourage workers to roll over their 401(k) plan savings into IRAs. GAO investigators found that call center staff often make recommendations with only minimal knowledge of a caller's financial situation. Investors may also receive "cold calls" pressuring them to roll over their savings and offering them various incentives to do so. In many if not most of these situations, this conflicted advice profits the call center staff and the firms that they work for, to the customer's detriment. A firm that operates according to such a harmful business model will have to substantially change its practices. That should be viewed as a feature, not a flaw, in the rule. As President Obama said recently, "If your business model rests on bilking hard-working Americans out of their retirement money, then you shouldn't be in business."

Won't the compliance costs on industry outweigh any benefits to retirement investors?

Using information from industry surveys, the DOL estimates that the compliance cost associated with the proposal will total between $2.4 billion and $5.7 billion over 10 years. Those estimated costs pale in comparison to the significant benefits that this proposal will provide. By limiting or mitigating advisers' conflicts, the new proposal will encourage competition based on the best interests of the investor rather than compensation to the adviser. Investment products that can't currently compete based on quality will have to adjust or risk losing market share. Market competition based on cost and quality should dramatically reduce both the excessive fees and the inferior investment performance associated with conflicted advice. Investors and sponsors of high-quality, low-cost products should both benefit from this approach.

Because of limitations of the literature and available evidence, only some of the potential gains can be quantified with confidence. Focusing only on how load shares paid to brokers affect the amount that IRA investors holding load mutual funds pay and the returns they achieve, the proposal has the potential to deliver gains of between $40 billion and $44 billion over 10 years just to these IRA investors. The potential gains to the entire retirement market are likely to be much greater. However, if only 75 percent of anticipated gains to IRA investors were realized, that would amount to between $30 billion and $33 billion over 10 years. If only 50 percent were

realized, that would total between $20 billion and $22 billion over 10 years. Even under the most conservative estimates, therefore, the benefits to investors of best interest advice are many times greater than the costs to industry of complying with this rule.

Broker-dealers are already extensively regulated by the SEC and FINRA. Aren't existing regulations adequate to protect all investors, including those saving for retirement?

The SEC and FINRA play an important role in protecting investors, including those investing for retirement, but there are significant gaps and weaknesses in that regulatory regime. The tens of billions of dollars that retirement savers lose each year as a result of conflicted advice stems from conduct that is permissible under the rules and laws overseen by the SEC and FINRA. Specifically, while broker-dealers market themselves as trusted advisers, it is still permissible for them to favor their own interests over the interests of their customers when recommending securities, as long as the investment is generally suitable. This falls well short of the protection retirement savers reasonably expect when they turn to someone for advice. While the SEC has the authority to reduce that harm by strengthening the standards that govern broker-dealers when they provide investment advice about securities, it has failed to act on that authority. In other areas, including the recommendation of insurance products and recommendations to retirement plans, the SEC and FINRA have no authority. Investors need both the SEC and DOL to act to ensure that they are adequately protected when they rely on financial professionals for advice. It is unfortunate that the SEC has lagged so far behind in providing those protections.

Shouldn't the SEC, rather than DOL, take the lead in setting standards for retirement advisers?

While the SEC is responsible for regulating securities professionals, the DOL has primary responsibility for protecting retirement assets, including by setting standards for those who provide investment advice with regard to retirement assets. When Congress adopted ERISA, it gave DOL sole rulemaking authority under the statute. DOL also has sole responsibility for interpreting the Internal Revenue Code (IRC) prohibited transaction provisions, which specifically apply to IRA investment advice. In the more than forty years since ERISA became law, the DOL's "role in interpreting those provisions has become well established under law and in practice." The SEC, on the other hand, has no authority to interpret the Internal Revenue Code provisions. It also has no authority with regard to non-securities retirement investments. It is therefore incumbent on the DOL to use its authority under ERISA and the Internal Revenue Code to protect retirement savers from harmful adviser conflicts. Based on the proliferation of IRA assets and the compelling evidence of adviser conflicts in the current IRA market, "the special protections in the IRC Prohibited Transactions are even more critical today than when Congress first enacted ERISA more than 40 years ago."

Shouldn't the DOL wait for the SEC to act so that the standards can be harmonized across all types of accounts?

When Congress enacted ERISA, it intentionally set a higher standard for protecting retirement assets than applies to other investments. There are good reasons to do so. Retirement assets are special, as evidenced by the fact that they are heavily subsidized by the government through the tax code. IRAs were subsidized by $16 billion in 2014. However, as the RIA

explains, "this figure drastically understates the degree to which current IRA savings have been subsidized by taxpayers. Because most of the savings flowing into IRAs comes from rollovers primarily from job-based retirement plans, much of the savings currently in these plans may eventually be rolled over into IRAs." The tax preference for defined contribution plans amounted to $45 billion in 2014. These tax subsidies should flow to individuals, not financial firms, and should not be depleted by conflicts of interest.

Furthermore, there is no assurance that the SEC will act to strengthen protections for investors who receive investment advice from broker-dealers. The SEC has been considering action for nearly a decade with no evidence of concrete progress. While recent statements of support from SEC Chairman Mary Jo White are encouraging, there is still no clear roadmap or timeline for finalizing a rule. The process could take years. Meanwhile, the current inconsistent standards would be perpetuated. The typically wealthier investors who invest through fee-based investment advisers would continue to receive fiduciary protections, while the small savers who are more typically served by commission-based broker-dealers and insurance agents would not.

Will the DOL rule conflict with securities laws?

Despite the different regulatory frameworks under which the two agencies operate, the DOL took great pains to draft its fiduciary rule to work in harmony with securities laws. The definition of investment advice proposed by DOL is virtually identical to the securities law definition. The best interest contract exemption deals directly with several issues that SEC would need to address if it adopted rules under Section 913 of the Dodd-Frank Act, including how fiduciary protections would apply to one-time advice, sale of proprietary products, and sale from a limited menu of products. The approach proposed by DOL is consistent with the provisions of Dodd-Frank. The DOL rule also deals very effectively with the question of how to mitigate conflicts of interest under the broker-dealer business model, a topic SEC has yet to take up despite a clear mandate in the Dodd-Frank Act to do so. This doubtless reflects the extensive consultation that has taken place between DOL and the SEC to ensure that the revised proposal would not conflict with the securities laws. The DOL explains that a key goal of the consultation was to ensure that compliance with the new proposal would not cause a regulated entity to be out of compliance with the securities laws. And, in the DOL's view, "the current proposed regulation neither undermines nor contradicts the provisions or purposes of the securities laws."

If retirement savers are confused, why not just improve disclosures? Wouldn't that achieve the same result at a lower cost?

As the DOL discusses at length in its Regulatory Impact Analysis, available academic and empirical evidence strongly suggests that disclosure alone is ineffective at mitigating conflicts in financial advice. First, extensive evidence demonstrates that a majority of retail investors are incapable of adequately understanding the implications of disclosed conflicts and factoring that understanding into their choice of adviser and investments. Furthermore, most retail investors are unlikely to have the financial sophistication necessary to check the quality of advice and detect adviser misbehavior. Many if not most investors also are likely to ignore disclosures. For example, the RIA cites the 2008 Rand Study that interviewed representatives of brokerage firms who reported extensive efforts to clearly disclose conflicts. Several acknowledged that "investors rarely read these disclosures...[F]or many investors, the fact that they were given disclosures was seen as meaningless."

There is even evidence that conflict disclosures can have a harmful impact on investors. Behavioral economists have found that, where investors are able to pay attention to and understand disclosures regarding adviser conflicts, they still may react to disclosures in ways that exacerbate the harms that can result from these conflicts. For example, they might interpret conflict disclosures as a sign of honesty or high professional standing, or feel socially constrained from questioning their adviser's integrity or threatening their livelihood. And, their adviser may feel "morally licensed" to pursue their own interests over their customers' interests after having warned them of their conflicts. One legal academic who has surveyed the literature of broker obligations, conflicts, and disclosure concludes that, "disclosure alone is a frail tool with which to attack the many ills that arise from blatant conflicts of interest in the financial industry."

Based on the extensive academic and empirical evidence, the DOL has rightly concluded that a rule that relies on disclosure alone to mitigate adviser conflicts would be ineffective, would yield little or no investor gains, and would therefore fail to justify the compliance cost associated with requiring increased disclosure.

Conclusion

Financial firms and their advisers are understandably nervous about a rule that could force them to make significant changes in the way they conduct their business. But change is necessary to ensure that retirement savers who turn to financial professionals for advice receive recommendations that promote their ability to enjoy a secure and independent retirement. The DOL has exceeded expectations in proposing a rule that carefully balances the need to strengthen protections for retirement savers with the need to allow compliance under a variety of business models. They have done everything that industry asked of them when they withdrew their 2010 proposal: they produced a comprehensive economic analysis showing the harm to investors that justifies rulemaking; they revised the rule to reflect the legitimate concerns raised by industry; and they issued the draft exemptions which are crucial to understanding how the rule will be applied in practice. They did all that while enhancing the rule's protections for retirement savers. While the rule will doubtless undergo some fine-tuning as a result of the comment process, this is a strong proposal that deserves all of our support.

Consumer Federation of America

Industry Claims That DOL Fiduciary Will Unleash Flood of Litigation Don't Hold Water

Industry groups seeking to stave off a new Department of Labor rule proposal to strengthen protections for retirement savers have argued that it would unleash a flood of litigation. While it is true that retirement savers with meritorious claims should find it easier to recover their losses if the rule is adopted, there is simply no basis for the claim that the rule would significantly increase the amount of litigation. To suggest that it would ignores not only the high cost of pursuing claims, and the particular difficulty of pursuing class action lawsuits, but the plain language of the rule itself.

Advisers Won't Face Lawsuits Based Solely on the Outcome of their Recommendations

Perhaps the most extreme of the claims with regard to litigation risk is that financial professionals will be vulnerable to lawsuits anytime their customers lose money on an investment they recommended or make less money than they could have made had they invested differently. This is patently absurd. There is no evidence that investment advisers who are subject to a best interest standard under securities laws face such claims. Moreover, the DOL rule proposal makes clear that recommendations will be assessed for compliance with the best interest standard based, not on the outcome of those recommendations, but on the circumstances prevailing at the time the recommendation was made.

Indeed, the DOL rule proposal poses even less of a threat of such litigation than the securities law best interest standard, since it does not automatically impose an ongoing duty of care on ERISA fiduciaries. Only where the adviser agrees by contract to provide ongoing account oversight would he or she would have to monitor the recommendation to ensure that it continues to serve the best interests of the customer under the DOL rule proposal. Absent such an agreement, there would be no ongoing duty and thus no basis for a claim. Moreover, even where the adviser has an ongoing duty, compliance with the standard would be determined based, not on hindsight, but on whether an impartial expert would view the recommendation as in the best interest of the customer in light of prevailing circumstances.

Finally, customers who wish to bring a case based solely on the outcome of the investment would be unlikely to find an attorney willing to represent them. Because of the unlikelihood of success, attorneys whose pay typically depends on the outcome of the claim would have no incentive to take such a case.

Class Action Lawsuits Will Remain Rare

Some opponents of the rule have seized on the provision prohibiting advisers from forcing customers to sign away their right to participate in class action lawsuits as representing a broad new expansion of liability. In reality, however, this provision merely reaffirms existing FINRA policy, which already prohibits any such limitations on customer rights. There are two main reasons to believe class actions will remain the rare exception, rather than the rule. The

first is that very few cases will lend themselves to class treatment. The second is that even cases that lend themselves to class treatment face significant barriers.

Claims based on violation of fiduciary duty turn on whether the recommendation was in the best interest of the customer. That is a very fact-specific determination that will differ for each customer based on his or her personal situation and needs. However, an attorney seeking to certify a class must prove commonality of the harm suffered throughout the class. As a result, the vast majority of claims based on violation of fiduciary duty simply will not lend themselves to class treatment and will continue to be brought as individual claims in arbitration.

Moreover, class actions face daunting procedural barriers that often prevent such actions from moving forward. First, a judge must approve of the formation of a class and allow the named plaintiff to bring the action on behalf of the class. For this to occur, a representative plaintiff must prove commonality of harm among class members, that the class is so numerous that it is impracticable to bring suit otherwise, that the claims or defenses of the named plaintiff are typical of the claims or defenses of the class, and that the named plaintiff will fairly and adequately represent and protect the interests of the class. Most classes seeking money damages also require a judge to find that issues common to the class members predominate over issues affecting individual members and that a class action is superior to other available methods of adjudicating the controversy. If a class manages to clear these hurdles and is certified by a judge, a defendant can appeal the court's decision, which can tie up the case and increase costs for a named plaintiff and his or her attorneys. The appeals process can delay, and often cripple the progress of a class action, turning it into a battle of attrition where the party with the most resources (usually the defendant) wins.

As a practical matter, smaller firms simply do not have a big enough client base to makes class treatment worthwhile. Instead, the most likely class action target under the DOL rule would be a large firm that, in clear violation of the rule, adopts policies and practices that encourage their advisers to provide conflict-ridden retirement investment advice. For example, a large firm that continued to use quotas and bonuses to encourage the sale of in-house products across its IRA platform could be vulnerable to class action litigation. Similarly, a large firm could face class action litigation if it relied on the best interest contract exemption to engage in widespread sale of products that are clearly not permitted under that exemption, such as non-traded REITS. These are precisely the sorts of situations where class actions provide an appropriate and effective mechanism to hold firms accountable for compliance with the rule.

Most Claims Will Continue to Go to Arbitration

For the reasons noted above, most claims brought under the DOL rule proposal are likely to be individual claims. Because the DOL's proposal specifically allows firms to include pre-dispute binding arbitration clauses in their contracts, the vast majority of these claims will likely be heard in the industry-run FINRA arbitration forum rather than in court. Although arbitration is promoted as providing an inexpensive alternative to court, the costs are sufficient to deter even small meritorious claims, let alone the frivolous claims industry argues are a threat under the DOL rule proposal.

For example, a combination of filing fees, discovery costs, expert witness fees, hearing session fees, and costs for a court reporter can easily add up to $30,000 before attorney's fees, according to attorneys who are familiar with the system. Most attorneys work on a contingency fee, which means they agree to front a significant portion of the litigation costs in return for

receiving reimbursement and a percentage of any recovery. Cases have to be worth their time, effort, energy and resources, otherwise they aren't going to invest in them. As a result, they have little if any incentive to take cases unless they expect to win and to win an award sufficient to cover the considerable costs of bringing the claim. Alternatively, an attorney can charge by the hour. That can add up very quickly to tens of thousands of dollars in legal bills that all but the wealthiest claimants will be unable to afford. If, despite these deterrents, an investor brings a frivolous claim, that investor may be responsible for paying the other side's attorneys fees, possibly amounting to tens of thousands of dollars.

The Rule Proposal Could Decrease the Amount of Litigation

One over-looked aspect of the rule proposal is its potential to reduce litigation by reducing predatory practices. In a recent letter to members, FINRA CEO Rick Ketchum noted that firms could significantly reduce their compliance problems and regulatory risks if they would put the interests of their customers first. By requiring firms to take concrete steps to eliminate practices that encourage bad conduct, the DOL rule proposal achieves what FINRA only suggests. Moreover, it would not only require firms and advisers to put customer interests first, it would also require firms to eliminate the practices that encourage advisers to act in ways that are not in the customer's best interest. By reducing the incentives to steer clients into inferior investment options, the rule should reduce abusive conduct. As a result, firms that take seriously their obligation to mitigate conflicts and put the interests of customers first should see their liability risks reduced as a result of the better outcomes they achieve for clients.

Meritorious Claims Should Fare Better under the DOL Rule

While the DOL rule would not increase the amount of litigation, it should improve the ability of those with meritorious claims to recover losses sustained as a result of abusive retirement investment advice. As a recent study by the Public Investors Arbitration Bar Association documented, the same financial professionals who routinely market themselves as objective advisers putting their customers first immediately drop that pose in arbitration and deny any such obligation. Because the rule proposal would force financial professionals who receive conflicted compensation to sign a contract in which they acknowledge their duty to give fiduciary advice, plaintiffs would no longer have to prove that a fiduciary relationship existed. Instead, it would be enough to show a violation of the standard, rather than that the standard applies.

* * *

Financial professionals who take advantage of retirement savers' trust should be held accountable for their abusive conduct. The DOL rule proposal provides that accountability without posing any credible threat of excessive litigation or frivolous claims. It deserves our strong support.

Consumer Federation of America

May 18, 2015

Dear Representative:

Small broker-dealers and insurance agents have been hearing ominous predictions from their trade associations for years about the consequences of a Department of Labor (DOL) rule proposal that would require them to meet the fiduciary standard of serving their clients' best interests when providing retirement investment advice. So it is not surprising that they are worried. The truth is, however, that the rule the DOL has proposed is very different from what they have been led to expect and will allow them to continue to serve their clients while earning sales-based compensation and selling from a limited menu of investment products. This approach will benefit retirement savers, the many advisors who already seek to serve their customers' best interests, and product sponsors that compete on the quality and cost of their investment options.

The DOL rule proposal would close loopholes in the definition of investment advice that have allowed broker-dealers and insurance agents to escape the fiduciary duty under the Employee Retirement Income Security Act (ERISA) when offering advice to retirement savers. At the same time, however, DOL has proposed exemptions that will allow these advisors to continue to maintain their sales-based business model subject to appropriate restrictions.

- They will have to enter into a contract with customers in which they promise to obey the law and provide advice that is in the best interest of the customer.
- They will have to charge reasonable fees for their services.
- They will have to take concrete steps to minimize conflicts of interest associated with their business model.
- They will have to provide point-of-sale and on-going disclosure regarding the cost of their services and the investments they recommend.

The same trade associations that previously sold these small advisors on the message that they wouldn't be able to charge commissions at all are now telling them that they won't be able to meet these reasonable compliance obligations. Their new predictions have no more factual basis than their earlier misinformation about restrictions on commission compensation. Indeed, small advisors that choose to offer a menu of high-quality, reasonably priced investment options will see relatively little impact from the rule. For example, contrary to the fear mongering they've heard from their trade associations:

- Advisors will remain free to recommend variable annuities, so long as the recommendation is in the best interest of the investor and the fees are reasonable.

Annuities are on the list of financial assets advisors can recommend when relying on the best interest contract exemption.

- Advisors will be free to sell from a limited menu of products, including a menu of products made up exclusively of proprietary products. When they do, they will simply have to notify their customers of this limitation on their services, ensure that the investment menu is sufficiently broad to allow them to meet their best interest obligation to recommend a diversified portfolio, and ensure that any fees charged do not exceed the fair value of services provided.
- Advisors who sell products with high fees will still be able to comply with the rule by rebating excess fees to the customer.
- Advisors will not be at risk of being sued just because an investment they recommend performs poorly. The rule proposal clearly states that the best interest determination is based on the conditions prevailing at the time the recommendation is made, not its ultimate outcome. Where disputes do arise, existing FINRA policy with regard to pre-dispute binding arbitration clauses will continue to apply.

In short, those broker-dealers and insurance agents who charge reasonable fees for recommendations that serve their customers' best interests will see relatively little impact from the rule, and could in fact benefit from a leveling of the playing field. Those whose business is built around the recommendation of high-cost, low-quality investment options will be forced to make a more dramatic adjustment, and appropriately so. Perhaps the biggest impact will be on product sponsors who, instead of competing on the quality and cost of their investment options, currently compete by compensating advisors more generously. They will have to either adjust or risk losing market share, and that too is an appropriate outcome of the rule.

Retirement savers deserve investment advice that will help them achieve a secure and independent retirement. The DOL rule proposal helps to achieve that goal while providing sufficient flexibility for advisors operating under a variety of business models to comply. It deserves all our strong support.

Respectfully submitted,

Barbara Roper

Barbara Roper
Director of Investor Protection

Appendix F: CFA Letter of Opposition to H.R. 1090

Consumer Federation of America

March 2, 2015

Re: Oppose H.R. 1090

Dear Representative:

Last week, Representative Ann Wagner (R-MO) introduced H.R. 1090, the cynically misnamed "Retail Investor Protection Act." This bill would erect new barriers to slow or stop efforts by the Department of Labor (DOL) and the Securities and Exchange Commission (SEC) to adopt new rules to require all financial advisers to act in the best interests of their clients when providing investment advice. By impeding their efforts, this bill would in no way protect retail investors; instead, it would protect those financial professionals who take advantage of loopholes in the law to profit at their clients' expense.

Under our current regulatory regime, certain financial professionals are allowed to hold themselves out as trusted advisers but not comply with the fiduciary standard that traditionally applies to those in a position of trust. Both the DOL and SEC are working to update and strengthen the ethical standards that apply when financial professionals provide investment advice to their clients. While some have suggested that these rules are likely to create conflicts, each agency has an important and unique role when it comes to protecting the quality of advice that financial professionals provide to investors.

Under the Employee Retirement Income Security Act (ERISA), the DOL has exclusive authority over retirement accounts, including traditional pension plans and defined contribution plans such as 401(k)s, and shared authority over Individual Retirement Accounts (IRAs). Under the securities laws, the SEC has exclusive authority over private securities accounts and shared authority over IRAs. The SEC's authority is limited to recommendations regarding securities, while the DOL's is not. Because neither agency currently requires all those who provide advice to act in their customers' best interests, both agencies must act to provide comprehensive protections governing the provision of investment advice.

The DOL is significantly farther along in its rulemaking process than the SEC. Last week, the DOL sent its proposal to the Office of Management and Budget for interagency review and it is expected that the proposal will be issued for public comment in the next few months. The SEC, on the other hand, has been studying the issue for years, and no one at the agency can provide a definitive answer as to when the SEC is going to move forward with its rulemaking process or even any assurance that it will.

This bill is a clear attempt to thwart DOL action by making the DOL wait indefinitely to proceed with its rulemaking to strengthen protections under ERISA until after the SEC finalizes a rule under securities laws. And, to further delay SEC action, the bill imposes on the SEC new

requirements to engage in further economic analysis, beyond the extensive analysis it has already conducted, and make formal findings before promulgating a rule. This approach puts both agencies in a vice, effectively crippling both their abilities to fulfill their unique and critical regulatory roles. Moreover, with no justification, it also subjugates an executive agency's jurisdictional authority to an independent agency's.

Investors face a multitude of complex decisions when saving for retirement and other important goals. They often turn to professionals for advice to help them navigate these difficult decisions. To ensure that the financial professionals are serving their clients' best interests, the rules that apply to financial advisers must be updated, and the DOL and SEC should be allowed to proceed with their rulemakings without manufactured roadblocks. Therefore, we urge you to oppose this ill-conceived and dangerous legislation.

Sincerely,

Micah Hauptman

Micah Hauptman
Financial Services Counsel

Barbara Roper

Barbara Roper
Director of Investor Protection

ConsumersUnion
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July 21, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Conflict of Interest Rule, RIN 1210-AB32
Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25

Dear Secretary Perez:

Consumers Union, the advocacy division of Consumer Reports,[1] is pleased to submit comments on the Department of Labor's (DOL's) proposed conflict of interest rule. Where appropriate we have also included comments from consumers who have written to us about the problems they have experienced when seeking investment advice. The proposed rule would significantly strengthen protections for consumers who are saving for retirement and those who want to retire with dignity knowing that their retirement income is secure. It would require financial advisers and their firms to provide retirement investment advice that is in the best interests of their clients rather than for their own financial gains. We urge the DOL to finalize and implement this rule as soon as possible.

Background

When consumers decide to leave a job or retire, they must decide what to do with the savings they have accumulated in their retirement plans. It is often at this point that many consumers realize they do not have the necessary financial expertise or tools to make important life changing decisions about how and where to invest their retirement savings. Many consumers turn to financial professionals for help in navigating the complex and often confusing world of financial investments. While many of these professionals commit to serving their clients' best interests, others may not. Because of gaps in current law governing retirement accounts, financial advisers are not required to make recommendations that are in their client's best interests. Advisers are allowed to

[1] Consumers Union is the public policy and advocacy division of Consumer Reports. Consumers Union works for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves, focusing on the areas of telecommunications, health care, food and product safety, energy, and financial services, among others. Consumer Reports is the world's largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit organization rates thousands of products and services annually. Founded in 1936, Consumer Reports has over 8 million subscribers to its magazine, website, and other publications.

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give imprudent and disloyal advice, steer plans and Individual Retirement Account (IRA) owners to investments based on their own, rather than their customers' financial interests, and to ignore conflicts of interest in ways that would be prohibited if the same persons were fiduciaries.

The cost to retirement saving of conflicted advice is staggering. Based on the best data available, the DOL estimates that investors will lose somewhere between $210 billion and $430 billion over 10 years and $500 billion and $1 trillion over 20 years as a result of conflicted advice with respect to mutual fund investments in IRAs. In addition, a retirement saver who moves money out of a 401(k) plan into an IRA based on conflicted advice can expect to lose 12 to 24 percent of the value of his or her savings over 30 years.

The proposed investor protection rule would update the fiduciary standard under our pension rules. It covers advice to traditional and defined contribution pension plans, such as 401(k) plans, as well as advice to plan participants and to those who save through IRAs. It clarifies and expands who, as a result of giving investment advice, is a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act (ERISA). It would require financial advisers to be held to a fiduciary standard of putting their clients' interests first and foremost, free of conflict and subject to liability for any harm resulting from conflicted advice they may provide. Advisers would no longer be allowed to profit from the advice they give, while their clients lose millions in unnecessary fees and low returns.

We support many of the provisions in the rule, most notably:

- Updating current retirement rules to reflect the modern financial marketplace where financially unsophisticated consumers are required to manage their own retirement savings;

- Protecting consumers from conflicted advice when they are steered into inappropriate investments that benefit the adviser but not the consumer;

- Requiring best interest contracts that would hold advisers and their firms liable for any losses that result from a breach of contract; and

- Requiring advisers to provide important point-of-sale and on-going disclosures showing the true costs consumers pay for investment advice upfront and over time.

- However, while the rule would give consumers much needed protections when seeking retirement advice, it is not perfect. We strongly oppose the inclusion of pre-dispute mandatory arbitration clauses in the consumer contracts.

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I. Current rules need to be updated to reflect the modern financial marketplace where unsophisticated consumers are required to manage their own retirement accounts.

When the fiduciary rule under ERISA was first promulgated in 1975, the retirement landscape looked very different from today's ever evolving financial marketplace. At that time, most consumers invested their retirement savings in a defined-benefit plans or traditional pension plans. IRAs had just been created, and 401(k)'s didn't even exist. Consumers didn't need personalized investment advice, because their retirement savings were being professionally managed for them. Regulators didn't take into account how the rule would affect financially unsophisticated individual consumers responsible for making their own decisions about how to invest their retirement savings.

Gaps in the rule do not require advisers to act in the best interest of the client when one-time or periodic advice is given. The current best interest rule only applies when there's a "mutual agreement" that the advice will be the "primary basis" for the investment decision. This requirement can easily be circumvented with fine print and legalese. In addition, the current rule does not apply to recommendations to roll over from a defined benefits plan into a self-directed IRA, one of the most important financial decisions many people will ever make.

We support the DOL's updates to the ERISA rule. Under the proposed rule, anyone (including brokers, registered investment advisers, insurance agents, or other type of adviser) who provides individualized investment advice to retirement savers whether they are saving through a traditional or defined contribution plan such as an IRA or 401(k), would be a fiduciary and required to provide best interest advice." Being a fiduciary creates a relationship of trust and requires the adviser to provide impartial advice and not accept any payments for that advice that would create a conflict of interest. The rule allows for conflicted compensation and requires that advisers who receive conflict compensation to enter into a contract with their customers in which they acknowledge their fiduciary status and commit to giving advice that is in the customer's best interest despite the compensation.

The rule would specifically eliminate the outdated "regular basis" loophole that allows advisers to provide one-time or episodic advice without being subject to a fiduciary standard. It also would close the "mutual agreement" and "primary basis" loopholes that allow advisers and their firms to evade the fiduciary standard. These updates are long overdue and will go a long way in securing the nest eggs consumers have spent a life-time building up.

Finally, the rule appropriately carves out education from its definition of retirement advice. This would allow firms and financial advisers to provide educational information and materials to consumers without being subject to a fiduciary duty as long as that information does not contain any specific investment recommendations that consumers can reasonably be expected to act upon.

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II. ***The rule would protect consumers from conflicted advice where they are steered into inappropriate investments that benefit the adviser but not the consumer.***

Jeanne, Dudley, MA

"I invested a large part of a $70,000 inheritance with a private financial advisor recommended by a family friend. I know absolutely nothing about investments. He constantly changed the investment each time paying himself a fee, I too late realized. When I finally learned that he had moved from the Massachusetts area to Florida, he had earned more money than I had.

Being personally responsible for one's own retirement investments comes with a lot of challenges. Consumers are faced with a multitude of complex and confusing decisions. They must decide how much to save, what types of retirement accounts they should use, and which products are best for them depending on their unique features, costs, benefits, and risks. Consumers often do not have the information, expertise or tools to make informed investment decisions about what is best for them. Many are forced to rely on the advice of professional advisers.

Because some advisers do not put their clients' interests first, they can freely steer them into excessively high costs, and low performing investments that drain their hard-earned savings while at the same time, increasing their advisers' profits. The compensation advisers receive for giving advice, works against consumers. If an adviser is paid based on the products the adviser sells, and selling one product makes the adviser an 8 percent commission instead of another product that makes the adviser a 3 percent commission, they may rationalize recommending the product with the 8 percent commission. And, if the adviser's firm is pressuring the adviser to hit specific sales quotas for selling the product with the 8 percent commission, and bases the adviser's compensation and bonus on hitting certain sales goals for that product, it creates conflicts that even the most ethical adviser would have difficulty avoiding. Many consumers may not know that their retirement savings are being slowly and deliberately drained because of these conflicts. The conflicts can be well hidden and are likely to result in excessive fees and low performing investments. Without adequate safeguards, retirement savers will remain at risk of being harmed by conflicted advice that is a direct result of skewed incentives and, sometimes, just plain greed.

III. Consumer Contracts – If the firm or adviser breaches any of the terms of the Best Interest Contract Exemption (BICE), the retiree can hold them liable for any losses that resulted from the breach.

Arthur, Charlestown, WV

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"The issue I have is that there is no recourse, no accountability for bad advice/recommendations in this field. ... They [financial advisors] should have to forfeit their fees if they lose for their clients".

Perhaps the most important feature of the rule is the Best Interest Contract Exemption (BICE), which would provide important protections for consumers from conflicted advice in a manner that would allow advisers and their firms to collect commission and other sales-related compensation. The broker-dealer business model would be preserved. To qualify for the BICE, advisers and firms would be required to contractually agree that any recommendations that they provide are in their client's best interest, without regard to their financial or other interests. This would mean providing advice that a prudent and impartial expert would provide under the same circumstances. In addition, the fees that firms and advisers charge must be reasonable in light of the services that they provide.

We also support the proposed rule's requirement that firms adopt policies that are reasonably designed to minimize the harmful impact of conflicts of interest. Firms would remain free to recommend proprietary or in-house products but could no longer set quotas for the sale of such products and base bonuses on their success in meeting those quotas. Similarly, while firms would be free to pay their advisers more to sell certain investments, those differential payments would have to be based on neutral and objective factors, such as the amount of time necessary to research and implement the investment strategy.

If firms or advisers breach any of the contractual provisions, consumers can hold them liable for any losses that resulted from the breach. We believe that having a mechanism to hold firms and advisers accountable will force advisers and firms to compete better on cost and quality rather than on how much they stand to profit from their advice.

IV. Advisers would be required to make important point-of-sale and on-going disclosures showing the costs that retirement investors are paying

Joe, Memphis, TN

"Retirement money should be saved not gambled. And the hidden fees should not be hidden only for you to find out later that you owe half or more to the adviser".

We also support the point-of-sale and on-going disclosures required by the rule. These disclosures will give consumers vital information about the long-term costs they are likely to pay for the advice received. This will give them the information needed to more effectively compare costs and services. Conflicts of interests like hidden fees that are often buried in the fine print, or kickbacks for selling certain investments, must be clearly and prominently disclosed and in some instances may be strictly forbidden. Consumers will also be able to see and understand the impact that costs can have on their retirement portfolios over the long-term. If firms or advisers breach any of the contractual

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provisions, retirement savers can hold them liable for any losses that resulted from the breach.

V. We strongly oppose the inclusion of pre-dispute mandatory arbitration clauses in the consumer contracts.

Under the rule, consumer contracts can require that individual disputes be handled through arbitration. We oppose this provision. A fundamental protection for consumers is the right to hold wrongdoers accountable under the law. This right is undermined when consumers are forced to give up their right to take their complaint to court and instead are required to go through forced arbitration. The arbitration process is often set up by the financial firm. It lacks many of the fundamental protections of established legal process, and is often unfairly skewed against consumers in the favor of the financial firm. Pre-dispute mandatory arbitration clauses should not be allowed in the consumer contracts. Consumers should have the right to bring their complaints to court.

Forced arbitration clauses also often restrict consumers from joining with other consumers who have been mistreated in the same way, by the same company, to bring a class action against the company. Without the ability to bring a class action, the cost of pursuing an individual claim is too high and often results in the wrongdoer being let off the hook.

The proposed rule would require the consumer contracts to preserve the right of consumers who have been harmed by a breach of the fiduciary standard to bring a class action in court. We agree that in situations where the adviser is committing the same kind of breach of duty against multiple consumers, allowing those consumers to join together in a class action is important. It makes the legal system a more effective means for consumers to recover damages and a more effective deterrent against adviser carelessness and misconduct that harms consumers. We strongly support this goal and the inclusion of this requirement in the rule. However, as DOL notes, this requirement is modeled after FINRA rules. The FINRA requirement has been challenged in court, and the Second Circuit ruled just last month that the FINRA requirement does not prevent forced class action waivers from being inserted in contracts and enforced. Cohen v. UBS Financial Services, Inc., Docket No. 14–781–cv. (2d Cir. June 30, 2015).

Moreover, there is substantial evidence that consumers may "win" FINRA arbitrations but receive significantly less than they deserve. For example, a study analyzing 14,000 FINRA arbitration awards over a ten-year period found that investors with significant claims suing major brokerage firms could expect to recover only 12 percent of the amount claimed.[2] There is also evidence that brokers are easily able to expunge their

[2] Edward S. O'Neal, Ph.D. and Daniel R. Solin, Mandatory Arbitration of Securities Disputes — by Edward S. O'Neal, Ph.D. and Daniel R. Solin1 A Statistical Analysis of How Claimants Fare, Securities and Litigation and Consulting Group, June 2007, http://bit.ly/1LtUCgU.

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records of consumer complaints, as if they never occurred.[3] In addition, arbitrators are not required to explain their decisions and their decisions are virtually impossible to appeal. The result is an opaque, unfair process that benefits the brokerage industry, not retail investors.

We continue to support legislation to protect consumers' right to bring claims in court rather than being forced to rely on binding private arbitration, and their right to bring a class action in accordance with long-established procedures. We urge the DOL to look for a more effective way to safeguard these rights for consumers in its rule.

Conclusion

We appreciate the DOL's hard work and thoughtful approach in developing a rule that would require financial advisers to put their client's interests first rather than their own when providing retirement investment advice. The harm that consumers suffer as a result of conflicts of interest can profoundly impact their quality of life during retirement, including where someone will live, whether they will be able to afford the necessities of life, and whether they can remain independent. Once their retirement funds are gone, they may not have the time, ability or opportunity to rebuild. They deserve more.

We urge the DOL to finalize and implement this rule as soon as possible.

Sincerely,

Pamela Banks

Pamela Banks
Senior Policy Counsel
Consumers Union

[3] Susan Antilla, *A Murky Process Yields Cleaner Professional Records for Stockbrokers*, NEW YORK TIMES DEALBOOK, September 25, 2014, http://nyti.ms/1uqiwyn.

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SECRETARY OF LABOR
WASHINGTON, D.C. 20210

AUG - 7 2015

The Honorable Ann Wagner
U.S. House of Representatives
Washington, DC 20515

Dear Congresswoman Wagner:

We received your letter dated July 29, 2015, signed by you and your colleagues, regarding the Department of Labor's proposed Conflict of Interest rule, which would require that retirement advisers put your constituents' best interests before their own profits.

The Department has undertaken incredibly thorough public outreach over the past five years as we have designed this proposal. When I became Labor Secretary two years ago, I committed to slowing down the process to ensure that all voices could be heard. As the result of lessons learned from the 2010 proposal and the robust listening process since, we issued a re-proposal in April 2015. This Notice of Proposed Rulemaking (NPRM), its expanded regulatory impact analysis, and proposed prohibited transaction exemptions published alongside are all directly responsive to the input received. The new proposal was designed to allow for the flexibility the financial services industry requested. This will ensure that your constituents are protected in a way that isn't unnecessarily disruptive for those who provide investment advice to retirement savers.

Since the NPRM was published, DOL staff have met over fifty times with the financial services industry and other interested organizations. I have also personally participated in many meetings with stakeholders. Each has been collaborative and constructive and they have certainly shaped our thinking. We received so far a total of over 330,000 comments from a variety of stakeholders, including 328,040 individual petition comments from members of the public, as well as comments from Members of Congress, the financial services industry, consumer advocates, and small businesses. We look forward to the public hearing which begins August 10, 2015, where this open and useful dialogue will continue and DOL staff will have the opportunity to talk directly once again to stakeholders.

This high level of interest and contribution to the process is indicative of a shift in attitude over the past few years – a recognition of the growing problem of conflicted advice, a desire to create a level playing field, agreement on the simple premise of putting the client's best interest first, and a "get to yes" attitude that will lead to a meaningful and workable rule. For these reasons, we will move forward towards issuing a Final Rule that balances the input we have received.

For your constituents and working families across our nation, the cost of inaction is too high: the Council of Economic Advisers conservatively estimates that conflicted retirement advice costs Americans $17 billion per year. Hardworking Americans deserve access to retirement advice that ensures that their best interests are aligned with the interests of the person providing that advice. This is a simple premise presented with an open mind.

We hope you will take this opportunity to encourage your constituents – including both financial services companies and retirement savers – to submit comments to the Department in the next open comment period if they haven't already. We continue to welcome input on how to refine and streamline this proposal so that when we publish a Final Rule, we can all be sure that it is reflective of relevant input and achieves its desired goals.

Sincerely,

THOMAS E. PEREZ

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