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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

    - 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. <u>The current rule bears little resemblance to the standard Congress set forth in ERISA, and it is riddled with loopholes that Congress never intended.</u>

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]

---

[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

[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

---

[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. <u>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.</u>

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]

---

[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

---

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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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.

---

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'

---

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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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.

---

[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

---

[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. <u>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.</u>

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]

---

[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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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.
>
>> 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;

---

[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

[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]

---

82 *Id.*
83 *See, e.g.,* 29 U.S.C. § 1132(a)(2), (3) & § 1109(a).
84 Release at 21970.
85 *Id.*

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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. <u>DOL should prohibit the use of mandatory pre-dispute arbitration clauses.</u>

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

---

[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]

---

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.

---

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. <u>The Proposed Rule will help, not hurt, low and middle income investors.</u>

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

---

[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.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

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]

---

[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,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Securities Specialist

Todd Phillips
Attorney

Elizabeth Cook
Project Coordinator

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
www.bettermarkets.com