July 21, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Conflict of Interest Rule, RIN 1210-AB32
Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25

Dear Sir or Madam:

The American Federation of State, County and Municipal Employees (AFSCME) is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1.7 trillion. In addition, the AFSCME Employees Pension Plan is a long-term shareholder governed by the Employee Retirement Income Security Act (ERISA) that manages $1 billion in assets for its participants, who are staff members of AFSCME and its affiliates.

AFSCME is pleased to have this opportunity to comment on the proposed definition of the term "fiduciary" by the Employee Benefits Security Administration (EBSA) of the Department of Labor (DOL). We strongly support the DOL's proposal to require those giving retirement investment advice to act solely in their client's best interest. We urge the DOL to adopt a definition that closes the current loopholes in the definition of investment advice so that everyone giving retirement investment advice must comply with the fiduciary duty under ERISA to put the interests of plan participants first. Plan fiduciaries, participants and Individual Retirement Accounts (IRA) owners need to be sure those providing investment advice are subject to ERISA's fiduciary standards.

Current rules are insufficient

We believe requiring advisors to act as fiduciaries is urgently needed and long overdue. The current rules are insufficient to meet the needs and demands of the modern financial marketplace. The retirement landscape has changed and is dramatically different than it was 40 years ago. When the fiduciary rule was adopted in 1975, workers and retirees did not need investment advice, because their retirement savings were being professionally managed and there were not nearly as many potential conflicts of interests facing professional money managers. At the time, regulators did not consider how the rule would affect unsophisticated individual workers and retirees seeking advice about their retirement savings and they did not foresee the proliferation of investment advisors and investment opportunities.

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In 1975 there were 105,000 defined benefit pension plans covering over 45 percent of private sector workers. By 2010, there were approximately 46,000 defined benefit plans covering 14 percent of workers. During this time the number of workers covered by defined contribution plans has increased greatly. The number of active participants in private-sector defined contribution plans increased from 11.2 million in 1975 to 75.4 million in 2012, while the number of active participants in private-sector defined benefit plans declined from 27.2 million to 15.7 million during the same time period.[1] According to the Investment Company Institute, 63 percent of U.S. households (or 77 million) reported that they had employer-sponsored retirement plans, IRAs, or both in mid-2014. Of the $24.7 trillion in assets for employer-sponsored retirement plans, the largest components of retirement assets were IRA and employer-sponsored DC plans, holding $7.4 trillion and $6.8 trillion, respectively, at year-end 2014.[2]

As a result, the responsibility of saving for retirement and managing retirement savings has been shifted onto workers, as most workers no longer rely on professionally managed pensions to guarantee a secure retirement, and the majority of workers participating in a retirement plan today find themselves in defined contribution plans, such as 401(k)s. And 401(k)s are interconnected with IRAs, as the majority of money in IRAs comes from rollovers from 401(k)s. The shift from traditional pensions has changed the responsibility of investment decisions, from professional managers making investment choices in a defined contribution system, to one where the investment decisions are the responsibility of the individual. Workers and retirees now must make investment decisions that can be confusing and yet are critically important. Given this new reality, workers and retirees often rely on investment advice to make these decisions. Unfortunately, there are loopholes in the 1975 fiduciary standard that allow financial advisors to give conflicted investment advice. Under current law, the financial professionals that workers and retirees turn to for investment advice are legally allowed to make recommendations that serve their own self-interest, at their client's expense. Although our focus is on the defined contribution system, the same problem afflicts defined pension systems, but to a lesser degree.

Investing is complex, and investors need advice they can trust

Investing is not a simple task for most Americans. According to a report on financial literacy by the Library of Congress, American investors do not understand basic financial concepts, such as compound interest and inflation; lack essential knowledge about concepts such as the meaning of stocks and bonds; and lack essential knowledge about investment fraud and the importance of investment costs and expenses.[3] Workers and retirees face a myriad of choices and decisions in an area where they do not have sufficient financial and investment expertise to make informed decisions.

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[1] U.S. Department of Labor. Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables and Graphs (June 2013), p. 9.
[2] 2015 Investment Company Fact Book, Investment Company Institute, pgs. 137, 139.
[3] Financial Literacy among Retail Investors in the United States, Library of Congress, December 30, 2011, pgs. 5-6.

Most people find themselves ill-equipped to navigate the complex choices they now face, so they rely on advisers for help. Investors are confused on whether a fiduciary standard applies in their relationships with financial intermediaries, and a majority trust that the advice they will be given will be in their best interest. According to a 2008 Rand Corporation survey of investors' beliefs about different financial service professionals, investors do not have a clear understanding about the distinction between broker-dealers and investment advisers and their different levels of fiduciary responsibility.[4] A 2010 survey found that 76 percent of investors believe that financial advisors are held to a fiduciary standard.[5] According to a 2014 investor survey, 70 percent of investors have confidence that financial advisors and brokers are looking out for their best interests. The same survey found a 72 percent of investors rely on financial planners, advisors and brokers for their investment advice. [6] So investors believe the advice they are getting from financial advisors is in their best interest, and the majority rely on advisors for advice for making investments.

Conflicted advice seriously harms investors

A major problem with the current DOL fiduciary definition is the narrow definition application of the "fiduciary" standard. Under the current regulation, for advice to constitute "investment advice," an adviser who is not a fiduciary under another provision of the statute must meet a five-part test for that advice to fall under the fiduciary standard. Under the five-part test, the fiduciary rule does not apply to one-time or periodic advice, and it only applies when there's a "mutual agreement" that the advice will be the "primary basis" for the investment decision. The five-part test provides loopholes for advisers to provide conflicted advice. Conflicted advice occurs when an advisor receives payments based upon decisions a client makes. The conflict occurs when financial advisers are compensated through fees or commissions that depend on clients' actions. Such fee structures are obvious conflicts of interest. What may be the best recommendation for a worker or retiree may not be the best for the adviser's compensation.

Conflicted advice leads to lower investment returns, leading to serious harm for workers and retirees. Numerous studies show workers and retirees are losing thousands of dollars in much needed retirement income as a result of this conflicted advice. According the White House Council of Economic Advisers (CEA), savers receiving conflicted advice earn returns roughly 1 percentage point lower each year, and CEA estimates the aggregate annual cost of conflicted advice to retirees is $17 billion each year. The CEA report also cites numerous studies showing that conflicted advice results in lower returns for savers and higher compensation for advisers. The CEA report finds that retirees who receive conflicted advice on how to invest their IRA at retirement will lose an estimated 12 percent of their savings. In the five years since the passage of Dodd-Frank, investors have lost more than $80 billion. The DOL's Regulatory Impact Analysis looking at the costs of conflicted advice upon IRAs estimates that retirees would lose between $210 billion and $430 billion over 10 years, and nearly $500 billion to $1 trillion over 20 years.[7] Put bluntly, the current system allows the financial industry to quietly rob retirees of their hard earned savings.

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[4] Angela A. Hung, et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, Rand Corporation, Sponsored by the United States Securities and Exchange Commission, January 2008.
[5] U.S. Investors & The Fiduciary Standard - A National Opinion Survey, ORC/Infogroup, September 15, 2010, p. 5.
[6] 2014 Main Street Investor Survey, Center for Audit Quality, pgs. 10, 16.
[7] Fiduciary Investment Advice Regulatory Impact Analysis, Department of Labor, April 14, 2015, p. 98.

Proposed rule

We strongly support the revised definition of investment advice that closes the most gaping loopholes in the five-part test. Specifically, the proposed rule will close the "regular basis" loophole that allows one-time or episodic recommendations to evade the duty. It will also close the "mutual agreement" and "primary basis" loopholes that allow advisers and their firms to disclaim mutuality through fine print. It will also update the rule to make clear that rollover recommendations would be covered investment advice, and therefore subject to fiduciary duties of prudence and loyalty. Advisers giving advice that investors rely on and believe is in their best interests should be consistent with fiduciary obligations.

We also support the Best Interest Contract Exemption (BICE). We believe this will provide important safeguards to protect investors from conflicted advice. To qualify for the BICE, advisers and their firms will be required to contractually agree that any advice and recommendations being given are in the client's best interest, without regard to their own financial or other interests. This is very important, as it puts an enforceable fiduciary duty in place. Additionally, firms will be required to have written policies and procedures in place to mitigate any harmful impact of conflicts of interest. This is a positive feature, as it guarantees firms undertake and put in place concrete policies and steps to avoid conflicts, and will be a reminder that advisers need to act in the best interests of their customers.

One area of concern with the BICE is the proposed allowance in the rule for firms to insert pre-dispute mandatory arbitration clauses in these consumer contracts. The proposed rule adopts the FINRA approach to arbitration. We believe arbitration should be a tool that is used voluntarily when both parties agree to use the process to resolve a dispute, whereas allowing binding, mandatory arbitration could lead to an opaque process that unfairly benefits the brokerage industry and harms retail investors. Pre-dispute mandatory arbitration would strip investors of their right to a judge and jury.

We also have a concern with the fiduciary standard applying to persons who "provide the advice pursuant to an agreement, arrangement, or understanding." Specifically, we believe that the word "understanding" is a term that lends itself to ambiguity. Under the five-part test of the 1975 rules, the "mutual understanding" element was prone to interpretation and often problematic, allowing for interpretations to establish a fiduciary standard did not exist. We are concerned that "understanding" could be interpreted in a way to require "mutual understanding" and provide a potential loophole to the standard.

In terms of financial industry claims that increased costs from proposed rule will cause small businesses to stop offering retirement plans or small investors to be priced out of the market for investment advice to the proposed rule, we believe the industry protests too much and that these claims are exaggerated. In a recent 2015 survey of investment advisers and brokers, 83 percent did not believe that a fiduciary standard of care would price investors out of the market for investment advice. Additionally, 91 percent did not believe it costs more to work with fiduciary advisors than brokers.[8] This survey's results refute the implication that it costs more to work with an adviser under a fiduciary standard or that smaller investors will be shut out of the market. Indeed, the study shows that there are already financial intermediaries working with small client investors every day under the standard. There are market participants who put the client first already providing services to small clients. If some financial firms claim it will be prohibitively expensive to serve small clients, they will likely lose market share to those who can, and will, provide advice under a fiduciary standard. Additionally, advisers who operate under a fiduciary standard save small investors' money by avoiding conflicted advice that lower returns. In light of the retirement security crisis facings millions of Americans, small investors need every dollar of savings they can get to meet their retirement needs.

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[8] Seeking Trustworthy Advice for Individual Investors, fi360, February, 2015, pgs. 31, 34.

Conclusion

The DOL's proposed rule would require all financial advisers who are providing retirement investment advice to serve their client's best interest rather than their own. This will strengthen protections for all retirement savers. The proposed rule will benefit working Americans and retirees and is long overdue.

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We appreciate the opportunity to share our views on this important rulemaking. If you have any questions, or need additional information, please do not hesitate to contact John Keenan at (202) 429-1232.

Sincerely,

Steven Kreisberg
Director, Department of Research
and Collective Bargaining Services

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