HD VEST
FINANCIAL SERVICES®

(800) 821-8254 (972) 870-6000 FAX (972) 870-6128
www.hdvest.com

July 21, 2015

VIA EMAIL

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

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

Dear Sir or Madam:

HD Vest Investment Services[sm] ("HD Vest") appreciates the opportunity to comment on the Department of Labor ("Department") proposed rule re-defining who is a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA), and related proposed exemptions (the "Proposal"). HD Vest is a broker-dealer with approximately 4,500 registered representatives nationwide. The firm conducts business primarily through tax professionals and accountants who have longstanding relationships with their clients and care deeply about helping them achieve their financial goals, including retiring with financial dignity.

HD Vest shares the Department's concern that Americans are not saving nearly enough for retirement, and that they need sound financial advice to navigate the complexities of modern investing. However, for the reasons set forth below, the Proposal will not achieve the Department's stated goals and on the contrary will materially harm the very retirement investors it purports to help. The proposed approach would create a bifurcated and disjointed regulatory scheme governing broker-dealers and their customers, and is not realistic in its assessment of the costs or benefits. We hope that the Department will consider these comments constructively, and significantly alter the Proposal. In particular, we encourage the Department to coordinate with the Securities and Exchange Commission ("SEC") and Financial Industry Regulatory Authority ("FINRA") jointly to craft a uniform fiduciary standard that would apply equally to all investors, including those who are saving for retirement outside tax-advantaged retirement accounts.

I. Financial Advisors Play an Important Role in Facilitating Retirement Savings and are Entitled to Fair Compensation

Financial advisors provide a highly valuable service to retail investors, and are entitled to reasonable compensation for their work. The goal of any regulation should be to preserve to the fullest extent possible the availability of this service at a reasonable cost. The Proposal falls short because it would reduce the availability of investment advice, increase its cost and limit consumer choice.

A. Financial Advisors Play a Critical Role in Facilitating Retirement Savings

As the Department pointed out, the current test for fiduciary investment advice under ERISA was adopted "in a very different context, prior to the existence of participant-directed 401(k) plans, widespread investments in IRAs, and the now commonplace rollover of plan assets from fiduciary-protected plans to IRAs."[1] The transition from defined benefit plans, coupled with heightened complexity in financial markets and products, has increased the challenges facing investors saving for retirement. Americans are now more responsible than ever for ensuring that they save enough for retirement, and this requires proactive financial planning. Unfortunately, it has become clear that without assistance and a financial plan they are unlikely even to define their retirement goals, much less achieve them. Therefore, the Department has correctly emphasized "the need for plans and IRA owners to seek out and rely on sophisticated financial advisers to make critical investment decisions in an increasingly complex financial marketplace . . . ."[2]

The fundamental premise of the Proposal, however, is that commission-based financial advisors are currently hurting their clients.[3] To justify the Proposal, the Department indicts the entire commission-based brokerage industry, laying at its feet hundreds of billions of dollars in alleged investor losses. This fundamental premise is controverted and controversial, and should not be taken as fact when fashioning regulations for the brokerage industry. Congress, the SEC and FINRA, who have much more extensive experience and expertise regulating the securities industry, have not reached similar conclusions. They therefore must either be complicit or lack the Department's unique insight. The Department's view is also not shared by millions of investors who have been well-served by having the option to obtain investment advice, trade

---

[1] DOL, *Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice*, 80 F.R. 21927, 21928 (Apr. 20, 2015) ("Proposed Rule").

[2] *Id.*

[3] *See, e.g.*, DOL, *Fiduciary Investment Advice: Regulatory Impact Analysis* at 7 ("A wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative."), *available at* http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf; *Id.* at 94 ("In sum, the weight of the evidence supports the finding that biased advice, rather than unobserved benefits, is the primary cause of the inferior returns suffered by IRA investors in conflicted load/distribution channels.").

execution, and a broad range of other valuable ancillary services in exchange for a commission that is both negotiable and subject to intense competition. Finally, the Department's sweeping conclusion will be news to the "[m]any advisers" who the Department itself acknowledges "do not provide biased advice . . . ."[4]

This is not to say that there is not room for improvement. Nobody writing on a blank slate would fashion a regulatory structure for the securities industry exactly as it exists today. However, the Department is not writing on a blank slate. There exists a complex framework of overlapping securities regulations developed over decades that must inform the Department's approach to a much greater extent. An important step in that process is recognizing that financial advisors play a critical role in helping investors – including retirement investors – in reaching their financial goals.

Financial advisors help inexperienced investors limit the harmful effects of the "human element" of investing. The study of "behavioral finance" has examined and documented what most of us intuitively know about investment decisions:

> Behavioral finance holds that investors tend to fall into predictable patterns of destructive behavior. In other words, they make the same mistakes repeatedly. Specifically, many investors damage their portfolios by underdiversifying; trading frequently; following the herd; favoring the familiar (domestic stocks, company stock, and glamour stocks); selling winning positions and holding onto losing positions (disposition effect); and succumbing to optimism, short-term thinking, and overconfidence (self-attribution bias).[5]

The Department dismisses the common-sense notion that financial advisors can help investors avoid emotional and harmful behavior, based primarily on alleged "inferior returns" of broker-sold products. Apart from focusing on research that purports to support its position (while ignoring a large body of contradictory research), the Department's analysis is flawed in that it does not quantify what it acknowledges are the "many" unbiased financial advisors in the commission-based brokerage channel. Is it 20%? Is it 50%? Is it 80%? If there are "many" unbiased commission-based financial advisors in the broker-sold channel, the Department's conclusions are questionable since the impact of "conflicted but unbiased" advice on the "inferior returns" the Department attributes to this channel is not discussed.[6] Moreover, the

---

[4] *See id.* at 7 (emphasis added).

[5] Seth L. Elan, *Behavioral Patterns and Pitfalls of U.S. Investors: A Report Prepared by the Federal Research Division, Library of Congress under an Interagency Agreement with the Securities and Exchange Commission*, at 1 (Aug. 2010) (footnote omitted).

[6] The Department later makes the generalization that "it is safe to predict that conflicted investment advisers . . . will act on their conflicts, and when they do, IRA investors will suffer as a result." *Regulatory Impact Analysis*, supra note 3, at 84. This contradicts the finding that "many" financial advisers do not act on conflicts and do, in fact, provide unbiased advice.

Department does not discuss why an unspecified percentage of financial advisers actually provide unbiased advice despite the presence of conflicts. The answer to that critical question seems necessary before proceeding with an entirely new regulatory framework based on broad assumptions about how conflicts impact financial advice.

Financial advisors also play an important role in encouraging American workers to save. Research shows that "[f]inancial illiteracy and the lack of trust in financial markets play important roles in curbing participation in retirement plans. Therefore, employer-sponsored retirement plans that require opt-in participation often encounter inertia and passivity on the part of employees."[7] The Department summarily dismisses the role financial advisors play in encouraging retirement savings, stating:

> Some comments appeared to exaggerate the extent to which advisers, especially brokers, currently advise small IRA investors and thereby increase their savings. In fact, small savers are far more likely to save through job-based retirement plans than through direct IRA contributions. IRAs are funded far more via rollovers from plans than by direct contributions encouraged by brokers or other advisers. Service providers other than brokers, notably banks, appear to serve most small IRA investors today.[8]

The implication is that, even if the Proposal limits access to investment advice, the savings rate by small IRA owners would not be adversely affected. This is both counter-intuitive and wrong. Lower net worth investors are less likely take advantage of employer-sponsored retirement plans if they are not receiving financial advice. Financial advisors who review a client's financial situation encourage contributions to employer plans as a good way to save for retirement, even when the advisor is not the "broker of record" who is paid for the transaction. Participation in employer plans, especially by smaller investors, would decrease if they were not working with financial advisors.

In addition, contrary to the Department's findings, HD Vest representatives routinely work with smaller investors to establish IRA savings accounts. They do not do it for the compensation, which is negligible for the amount of time and work it takes, but rather to encourage their clients to save even a little bit each year. An investor working with a financial advisor is much more likely to overcome the inertia that leads to under-allocating resources to retirement savings. People who periodically review their financial situation with a professional and come up with a financial plan are more likely to open a retirement account and contribute to it regularly. The Department should not dismiss the negative impact the Proposal would have on these people. Workers who have not saved at all will have bigger problems as they approach

---

7 *Behavioral Patterns and Pitfalls of U.S. Investors*, supra note 5, at 4.

8 *Regulatory Impact Analysis*, supra note 3, at 186.

retirement than worrying about whether some academic study concluded that investment returns might have been higher if their financial adviser were paid differently.

In addition to encouraging retirement savings, the following is a non-exhaustive list of areas, all of which can have a significant impact on retirement, where investors are likely to make better choices with the help of an investment professional: (1) periodically rebalancing their portfolio; (2) periodically reallocating their portfolio based on changing objectives and economic circumstances; (3) anticipating and saving for health care costs; (4) investing to mitigate longevity risk; (5) saving for education; (6) estate planning; (7) deciding when to access social security for maximum benefits; (8) choosing the right type of retirement account (they are not all equal); (9) optimizing their retirement age (not retiring too early); (10) keeping beneficiary designations current; and (11) having reasonable assumptions about their ability to withdraw funds in retirement. In addition to advice in these (and other) areas that do not necessarily generate additional commissions, there are numerous ancillary services that commission-based brokers currently provide without charging additional fees.

Retired clients, who generate less commission revenue because they have passed the "accumulation" phase and are entering the "distribution" phase of the investment lifecycle, often continue to receive a broad range of advice and other services without paying additional fees. The Department notes that clients could face higher overall fees in fee-based accounts, but acknowledges that advisory accounts offer clients additional valuable services.[9] This ignores the fact that commission-based brokers typically provide valuable ancillary services to long-term clients to help them manage through retirement and the transfer of wealth to the next generation. The Department's analysis does not adequately consider the impact on these clients if their financial advisor were, as a result of the Proposal, instead forced to charge a continuing annual fee over the entire course of their investing life.

B. The Proposal Would Increase Costs to Retirement Investors

The fundamental premise underlying the Proposal is that brokers routinely act in their own self-interest, and by reducing conflicts (or preserving them subject to additional regulation) the Proposal would result in a mass savings to retirement investors in the hundreds of billions of dollars. A significant flaw in this assumption is that the Proposal would, without doubt, significantly increase the complexity and cost of offering a simple mutual fund to a tax-advantaged retirement account. Rules that increase costs to financial firms typically do not reduce the price of their services for investors.

The so-called "illicit" payments brokerage firms receive through 12b-1 fees and revenue sharing have become necessary to compensate firms and their representatives for: (1) the

---

[9] *Regulatory Impact Analysis*, supra note 3, at 174.

products and services they provide for the client; (2) the already substantial and continuously increasing compliance costs associated with operating in a complex and heavily regulated business; and (3) a reasonable profit. As NASD (now FINRA) recognized when it considered additional regulation of revenue sharing in 1997, "existing commission-based compensation systems may reflect legitimate business considerations that derive from a competitive market."[10] These "legitimate business considerations" – which the Proposal ignores – are integral to the way the securities industry operates. The Department cannot just prohibit the payments, or impose significant additional and costly restrictions, and hope that firms will simply do more for less. While the Department grossly underestimates the cost of *its own* proposal, the problem is compounded exponentially by the fact that it does no analysis of the *overall* cost of current securities regulation for broker-dealers, or how the Department's *incremental* cost would impact the industry, competition or capital formation.

The *Federal Register* is packed with well-intentioned rules that require firms to do more and charge less. The cost of recommending a simple mutual fund (even a low-cost index fund) has <u>increased</u> exponentially over the last twenty years, while sales compensation has simultaneously <u>decreased</u>. The average front-end sales load investors paid on an equity mutual fund in 1990 was almost 4%; by 2014 it fell to only 0.9%.[11] During this 24-year period the industry increased in complexity with the number of mutual funds proliferating from 3,079 to 7,923.[12] At the same time, increased regulation and "innovations" in the fund industry have made it much more costly simply to sustain an open-architecture mutual fund platform. These include (but are by no means limited to) multiple share classes, breakpoints, contingent deferred sales charges, shares charge waivers, 12b-1 fees, omnibus accounts, sub-accounting, networking agreements, no-transaction-fee programs, reinstatement rights, rights of accumulation, letters of intent, tax reporting, market timing restrictions, redemption restrictions, non-cash compensation, prospectus delivery, confirmation delivery, and point-of-sale disclosure.

In other words, the trend for the past 24 years has been that financial advisors recommending mutual funds must do *significantly more work* and at the same time investors *pay substantially less* for financial advice. This trend has benefitted investors, and belies the notion that the industry is systematically working in its own self-interest to their detriment. It is axiomatic, however, that costs cannot continue to increase indefinitely while revenue simultaneously decreases. Revenue-sharing arrangements and 12b-1 fees the Department criticizes as improper incentives are needed in part precisely because of the complexity of

---

[10] NASD, *Notice to Members 97-50* (Aug. 1997), *available at* https://www.finra.org/sites/default/files/NoticeDocument/p004655.pdf.

[11] Investment Company Institute, *2015 Investment Company Factbook* at 105 (figure 5.8), *available at* https://www.ici.org/pdf/2015_factbook.pdf.

[12] *Id.* at 177.

existing securities regulation. If the Department wants to decrease the cost of mutual fund investing for retirement investors, it will not accomplish this through rules that add significant additional requirements, risk, complexity, ambiguity, and cost to the product. Ultimately, the increased costs associated with the Proposal will have to be passed on to consumers of retirement advice.

The Department's preference for flat-fee arrangements charged directly to retirement investors also would likely increase the overall amount many pay for advice and other services. For instance, revenue sharing is typically paid by a fund's investment adviser, not by the fund itself. As such there is no direct cost to fund investors. Furthermore, the indirect impact on fund investors is speculative. As the SEC has stated:

> Revenue sharing arrangements not only pose potential conflicts of interest, but also may have the indirect effect of reducing investors' returns by increasing the distribution-related costs incurred by funds. Even though revenue sharing is paid to broker-dealers directly by fund investment advisers, rather than out of fund assets, it is possible that some advisers may seek to increase the advisory fees that they charge the fund to finance those distribution activities**.** It is not clear whether that has occurred. *See* U.S. General Accounting Office, *Mutual Funds: Greater Transparency Needed in Disclosures to Investors* (June 2003) at 39 (discussing uncertainty about how revenue sharing has affected fund fees).[13]

For a commission-based firm to earn the same compensation under a flat-fee arrangement (which the Department assumes it can), the client would have to pay this amount directly, which would increase the investor's direct cost. Moreover, revenue sharing is typically paid at the firm level and is not paid to individual financial advisors; as such, it does not present a conflict of interest at the point of sale.[14] Because revenue sharing is not paid out of fund assets, and does not present a direct conflict at the point-of-sale, the correlation the Department suggests between revenue sharing payments and reduced investor returns is highly questionable.

In sum, regardless of what label is used for these fees, substantively there is no basis for the Department's global conclusion that (a) payments are excessive in relation to the services provided; or (b) overall costs to investors would decrease as a result of the Proposal. In fact, the opposite is true.

---

[13] SEC, *Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds*, Release No. 34-49148, 69 F.R. 6438, 6441 n.21 (Feb. 10, 2004) (proposed rule) (emphasis added).

[14] *See Notice to Members 97-50*, supra note 10 ("A disclosure approach would seem to require, at a minimum, a determination of what kind of information would need to be disclosed (*e.g.,* only those cash compensation arrangements that raise significant point-of-sale conflicts, such as sales contests, rather than entity-level, revenue sharing arrangements . . . .") (emphasis added).

II. The Proposal Would Reduce Investor Choice and the Availability of Financial Advice at a Reasonable Cost, Especially for Small Investors

The Department's answer to investors' need for sound financial advice is hundreds of pages of complex, burdensome, ambiguous and impractical conditions and prescriptions that undoubtedly will result in *fewer* Americans having access to meaningful financial advice. The Proposal would reshape the financial advice industry in ways the Department cannot possibly predict. The Department assumes without justification that an expansion of the ERISA fiduciary requirements will result in a mass transfer of wealth to investors with minimal complications, disruptions, unintended consequences or downstream effects. Based on these unwarranted assumptions and conclusions, the Proposal takes an overly prescriptive, one-size-fits-all approach to complicated issues and products, and even more complicated markets involving inter-connected participants of different types and sizes and business models already subject to extensive regulation. It clearly and explicitly favors certain business models and products over others. The predictable effect will be that many retirement investors who currently have access to financial advice at an affordable price will no longer be able to "seek out and rely on sophisticated financial advisers to make critical investment decisions in an increasingly complex financial marketplace."

The Proposal will negatively impact investors by increasing barriers to entry in the retirement advice market, and decreasing competition and consumer choice with respect to financial advisors and the products they can offer. Firms will have to increase fees to account for the added complexity and risk, or exit the market altogether. There is already a clear trend of firms and registered representatives exiting the industry in large numbers under a constant barrage of new regulations. At the end of 2007, there were 5,005 securities firms and 672,688 registered securities representatives.[15] As of December 31, 2014, there were fewer than 4,100 brokerage firms and about 636,700 registered securities representatives.[16] In other words, 18% of the brokerage firms in the industry in 2007 were no longer around by 2014.

This is a disturbing trend in that the reduced supply of advisors is coming at a time when the demand for advice is increasing. Unfortunately, as compliance costs increase closing shop is the only realistic option for firms that do not have the scale or capital to deal with ever-increasing regulatory burdens.[17] Every new regulation adds to the cumulative cost of doing

---

[15] FINRA, *2007 Year in Review and Annual Financial Report* at 2, *available at* http://www.finra.org/sites/default/files/Corporate/p038602.pdf.

[16] FINRA, *2014 Year in Review and Annual Financial Report* at 14, *available at* http://www.finra.org/sites/default/files/2014_YIR_AFR.pdf.

[17] *See, e.g.,* No-Action Request Letter from Michael F. Farrell, MGI Securities, Inc. to Michael Macchiaroli, U.S. Securities and Exchange Commission, 1992 WL 136464 (Mar. 31, 1992) (principal of small broker-dealer explaining that he is filing Form BDW to withdraw broker-dealer registration "for several reasons, the most

business, and the Proposal would add significant incremental requirements to an already suffocating regulatory framework. To understand the likely effects of the Proposal, it is important that the Department evaluate it in the broader context of existing regulatory requirements. Even if firms can absorb the effects of an individual incremental rule, the cumulative effect of new and increasingly complex requirements will continue to cause the extinction of brokerage firms. The Proposal's negative impact would be especially pronounced on smaller firms, many of which service retail investors in rural and less densely populated areas. The Proposal, therefore, would further disenfranchise a segment of the market for retirement advice that is already underserved by larger wirehouse firms.

III. The Proposal Could Have Potentially Dramatic Effects on Capital Markets

It is beyond question that the Proposal's direct impact will be to reduce consumer choice and competition, and increase the cost of retirement advice. The indirect impacts of the Proposal are harder to guess; however, given the significance of retirement assets to the capital markets the consequences of guessing wrong would be disastrous.

For example, the Department clearly and explicitly favors index mutual funds over actively managed funds.[18] The Department equates index funds with "products that are in the best interest of the investor," and actively managed funds with "products that are not in the best interest of the investor."[19] The Department then posits, in a prodigious understatement, that as a result of the Proposal "[p]assive and other lower cost investments may gain market share."[20]

The Department's statements regarding actively managed funds – which are highly controverted and controversial – have broad implications the importance of which cannot be overstated. If the Proposal is adopted, assets would be reallocated to index mutual funds as a result of firms' need to avoid liability and other consequences of non-compliance in light of an ambiguous "best interest" standard and the Department's own preferences, not the relative merits of those investments. The Department should exercise extreme caution before concluding – on behalf of all investors today and in the future – that it knows best how to allocate capital.

Importantly, if the Proposal is adopted, brokers forced to follow the Department's bias against actively managed funds (rather than their own opinion of their clients' "best interests")

---

important ones being the costs associated with a one man firm and the ridiculous amounts of filing requirements for a simple firm selling mutual funds on an application way basis").

[18] *See Regulatory Impact Analysis*, supra note 3, at 76 ("It turns out that the excess cost of active management – trying to identify and buy (sell) underprices (overpriced) securities – is almost always higher than any gain in performance over a lower-cost, passive management approach. As a result, past superior performance by an active manager more often reflects luck than skill . . . .").

[19] *See id*. at 228.

[20] *Id*.

could fuel an exodus of retirement assets from actively managed funds. Because mutual funds are large conduit investors in equity and debt securities, the Department's *de facto* mandate would also cause a major reallocation of capital in the underlying companies owned and financed by those mutual funds. The impact on demand for equity and debt securities of companies owned by actively managed funds is unclear, but capital undoubtedly would become much more expensive for companies that are not included in a popular index.

The Department's proposed approach would effectively transfer the responsibility for allocating investment capital away from thousands of portfolio managers who compete for investors in an intensely competitive marketplace to a select few companies who design popular indexes. As a result, popular index creators would wield unconscionable power to allocate (and re-allocate) scarce capital. The Department should consider that companies selected for indexes generally are chosen based on factors irrelevant to whether they would make good retirement investments. Moreover, many indexes are capitalization-weighted (*i.e.*, the largest amount of each dollar invested gets allocated to the largest capitalization companies in the index). Apple and Exxon Mobil will be big winners under the Department's passive management gambit. Small- and medium-cap companies that are not in an index, on the other hand, could see their access to public capital dry up altogether.

This scenario is not unlikely given the ambiguity of the Department's proposed standards and its derogatory statements regarding actively managed funds. In any event, choosing retirement assets based solely on the style of fund management and cost, rather than the merits of the underlying investments, will have a significant impact on the markets and result in a highly inefficient allocation of capital.

IV. The Proposed Best Interest Contract Exemption is Impractical, Especially for Smaller Accounts, and Will Cause Substantial Disruption in the Market for Advice

At the heart of the Department's Proposal is the notion that it is meant to mitigate the effects of conflicts of interest but otherwise is business-model neutral. The proposed best interest contract exemption ("BICE") purports to preserve flexibility with respect to how retirement investors pay for financial advice and how ERISA fiduciaries are compensated, subject to compliance with a torrent of new regulatory requirements. The proposed BICE does not leverage existing compliance systems developed under the securities laws or even the Department's own rules, and includes requirements that are impractical, if not impossible, to implement. For all intents and purposes, an impractical exemption is the same as no exemption at all.

The Securities Industry and Financial Markets Association ("SIFMA") and Financial Services Institute ("FSI") set out in detail many of the issues that firms would face in attempting to comply with the BICE, and HD Vest joins in these comments. Based on these concerns and

others, HD Vest does not anticipate attempting to rely on the BICE as it is currently proposed. In particular, HD Vest believes that the various disclosure requirements in the BICE should be dropped or significantly amended. The following are some of the major concerns that need to be addressed before the BICE would have any practical application:

- Proposed disclosure requirements should leverage existing systems, including expensive processes recently developed to comply with Department fee disclosure rules.
- The proposed cost disclosure at the time of purchase is unworkable in that firms cannot compile the required information and the proposed time and method of delivery is unrealistic. This is particularly troubling given the expanded scope of casual conversations that would be swept up within the scope of the revised "fiduciary" definition.
- The proposed annual disclosure requires information that is not currently available and cannot be developed at reasonable cost.
- The proposed web page disclosure is overbroad and unduly costly.

In the absence of a meaningful and practical exemption, broker-dealers will not be able to continue to do business under a commission-based model. As FINRA noted in its comment letter:

> If the Proposal were adopted as is, many broker-dealers will abandon these small accounts, convert their larger accounts to advisory accounts, and charge them a potentially more lucrative asset-based fee. They will do so largely because of the BICE constraints on differential compensation, the ambiguities in the best interest standard, the lack of clarity concerning various conditions, the costs of compliance, and uncertainty about the consequences of minimal non-compliance.

Broker-dealers are not permitted to offer flat-fee arrangements for advice without registering as an investment adviser.[21] In the absence of a meaningful exemption, a collateral impact of the Proposal will be that additional firms will have to either abandon their clients or register as investment advisers to offer flat-fee arrangements. Even if there is an ostensibly workable BICE, if the compliance costs associated with the exemption are significant, representatives may still choose to convert to a registered investment adviser ("RIA") model to offer flat-fee arrangements.

The Department made certain assumptions about the conversion cost registered representatives would face, and assumed "that five percent (approximately 11,000) of BD registered representatives will convert to RIA status in each of the first five years as a result of

---

[21] *See Financial Planning Ass'n v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

the new proposal and that half as many will convert in each subsequent year."[22] Given the problematic structure of the proposed BICE, this underestimates the number of firms that will have to adjust their business model. Even if the conversion rate were only five percent, however, the Department did not consider the impact these conversions would have on its sister regulators. The SEC and states have jurisdiction over RIAs, and therefore would have increased obligations imposed upon them if the Proposal is adopted. While it is not the Department's direct problem, the SEC has already made clear that it does not have the resources to effectively examine existing RIAs,[23] and it is not clear how the SEC and states would meet the Proposal's unfunded regulatory mandate with respect to a significant number of new RIAs.

V. The Department Should Issue Rules Jointly with the SEC to Provide Uniformity and Avoid Unintended Consequences

Based on all these considerations and many others, to avoid significant unintended consequences and disjointed and bifurcated regulation of retirement accounts, the Department should act jointly with the SEC to establish uniform rules for investors.

A. There Should be a Uniform Best Interests Standard Applicable to all Investors

If the Proposal is adopted, financial advisors would deliver advice to clients under different standards of care depending on the account registration. Serving the same client who owns an IRA and a non-IRA account under different standards only creates unnecessary confusion. Advisors should work under one standard that can be easily explained to clients.

The Department's proposed regulations police subjects at the very core of the SEC's jurisdiction. To the extent there is a problem that can be solved through a fiduciary standard, the Department should work with the SEC to adopt a uniform standard applicable to all investors. The Department has said that it cannot wait for the SEC to finish its work because the Department has a mandate to protect retirement investors. However, the proposed rules do nothing for the significant number of investors who save for retirement outside tax-advantaged accounts. According to the ICI, only 63% of American households even have a tax-advantaged retirement savings account.[24] What about the rest? Not only would the Proposal not help these investors, the Department's prescriptive approach, and the changes it would require specific to ERISA fiduciaries, would actually make the adoption of a universal fiduciary standard more

---

[22] *Regulatory Impact Analysis*, supra note 3, at 173.

[23] *See* Mary Jo White, *Testimony Before the U.S. House of Representatives Comm. on Appropriations, Subcomm. on Fin. Svcs., and General Govt.* (May 7, 2103) ("During FY 2012, although the SEC continued to use and improve risk-based analysis to select examination candidates in its examination program, it was able to examine only about eight percent of registered investment advisers. Over 40 percent of advisers have never been examined."), *available at* http://www.sec.gov/News/Testimony/Detail/Testimony/1365171516034.

[24] *2015 Investment Company Factbook*, supra note 11, at ii (2014 Facts at a Glance).

difficult. If the Department really wants to make a difference for all retirement investors, it should work with the SEC to create uniform protections that would apply beyond ERISA.

HD Vest supports the adoption of a uniform best interest standard. Our Advisors already act in their clients' best interests, and have no problem being held to a best interest standard with respect to all of their investment advice. Any standard, however, whether it is adopted exclusively for tax-advantaged retirement accounts or more broadly, has to consider the realities of the securities industry and markets, leverage existing compliance systems and infrastructure and truly seek to preserve investors' ability to choose how they obtain and pay for financial advice. As FINRA noted in its comment letter, "the Proposal should be based on existing principles in the federal securities laws and FINRA rules. In doing so, the Department would help remove many of the ambiguities that will frustrate good faith attempts at compliance, would conflict with existing rules, and would better ensure that the Proposal's objectives are achieved." The principles articulated by SIFMA and FSI provide an excellent framework and significantly advance the consideration of a uniform standard. FINRA's guiding principles for a uniform fiduciary standard also provide a framework that can be converted into rules if the various agencies can work in tandem to resolve differences in approach. Cooperation and coordination will avoid the unnecessary costs of an ambiguous and disjointed regulatory scheme to the great benefit of investors and the securities markets.

B. Working With the SEC on Joint Rules Would Help Avoid Significant Unintended Consequences

As the Proposal recognizes, "[s]ince the Department issued its 1975 rule, the retirement savings market has changed profoundly. Financial products are increasingly varied and complex."[25] The complexity of financial products, however, is nothing compared to the complexity of the securities markets themselves. The Department concludes that, because of this increased complexity, it should step into the breach. On the contrary, the heightened complexity of the markets makes it much more likely than it was 40 years ago that the Department's radical new approach will result in significant unintended consequences. Indeed, the SEC's deliberate approach to the uniform fiduciary standard rulemaking under section 913 of the Dodd-Frank Act reflects the significant amount of time and work necessary to understand the impact and reduce unintended consequences. The SEC has greater experience, expertise, historical context, knowledge and resources to fashion conduct standards for the securities markets, and was specifically empowered by the Dodd-Frank Act to do so. These factors counsel strongly against the Department acting on its own to adopt and enforce prescriptive regulations in this area.

Moreover, Congress has enacted specific checks and balances in the securities laws to ensure that regulations affecting the securities markets and market participants do not impede

---

[25] *Proposed Rule*, supra note 1, 80 F.R. at 21951.

efficiency, competition and capital formation. Section 23(a)(2) of the Securities Exchange Act of 1934 provides that:

> The Commission and the Secretary of the Treasury, in making rules and regulations pursuant to any provisions of this chapter, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission and the Secretary of the Treasury shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter. The Commission and the Secretary of the Treasury shall include in the statement of basis and purpose incorporated in any rule or regulation adopted under this chapter, the reasons for the Commission's or the Secretary's determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of this chapter.[26]

In granting the SEC specific authority to adopt rules governing product-specific disclosures for retail investors, Congress again included a requirement that "the Commission shall consider whether the rules will promote investor protection, efficiency, competition, and capital formation."[27] Congress was clearly concerned about the degree to which additional disclosure requirements could impair the securities markets. This is a critical consideration given the extensive degree to which the Department would mandate specific and highly burdensome disclosures regarding securities products and services.

The fact that ERISA does not contain the same strictures does not mean that these considerations are not germane to the Proposal. A more likely explanation is that Congress never contemplated that the Department would use the ERISA definition of "fiduciary" to pass sweeping rules on matters within the core of the SEC's jurisdiction under the securities laws. The Department's proposal circumvents these statutory requirements and the result, while well intentioned, represents risky experimentation with a significant portion of the U.S. economy. At a minimum, the Proposal will establish a radically different regulatory regime for retirement and non-retirement investors. At worst, it will be extremely disruptive to competition and access to capital. It is important to keep in mind that the Department's proposed requirements would be in addition to, not in place of, the already over-complicated, costly and often redundant and/or contradictory regulations imposed by a myriad of federal, state and self-regulatory securities and banking regulators. The Proposal will increase investor confusion and decrease access to

---

[26] 15 U.S.C. § 78w(a)(2); *see also id*. § 78c(f) ("Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.") (emphasis added).

[27] *Id*. § 78o(n)(2).

securities professionals and the securities markets. The lives of retirement investors will be impacted by the Proposal, but not in the ways the Department intends and not for the better.

Sincerely,

Roger C. Ochs
President & CEO