Davis & Harman LLP

September 23, 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 NW
Washington, DC 20210

RE: RIN 1210-AB32 – Conflict of Interest Rule

Dear Sir or Madam:

On behalf of a group of firm clients, I am writing today to provide supplemental comments on the Department of Labor's ("DOL") proposed new definition of a fiduciary, the proposed new prohibited transaction exemptions, and the proposed modifications of existing exemptions (together referred to as the "proposal"). Overall, while we share the belief that firms should act in their clients' best interest, the DOL's proposal, as currently drafted, is unworkable.

During the hearing held August 10-13, 2015, the DOL raised many possible issues with respect to the proposal. This supplemental letter focuses primarily on those issues.

DEFINITION OF FIDUCIARY.

Education.

Plan context. During the hearing, DOL asked whether it would be helpful to modify the education carve-out in the following manner with respect to plans but not IRAs. Under the possible modification of the education carve-out raised by the DOL at the hearing, references to specific plan investment options would be permitted if both of the following conditions are satisfied:

- All investment options that are in the recommended asset class and are available under the plan must be referenced ("first requirement").
- The provider of the education must not have a financial interest in the investments referenced ("second requirement").

The second requirement would appear to generally prohibit most plan service providers from providing the education, since most service providers will earn different amounts with respect to different investments. Accordingly, this change to the proposal would provide very little help. Moreover, if all the service provider is doing is listing all funds in a specified category, why should it matter whether the service provider has a financial interest in which option is chosen? The service provider is not exercising any meaningful discretion.

In most cases, the first requirement is quite workable, since a large number of plans have only a few investment options in each asset class. But there may be plans with, for example, 50 options in a particular asset class. In this case, providing 50 options in each class to a participant will be simply overwhelming and thus will not be helpful to the participant. Accordingly, we believe that there should be an exception from the first requirement where there are more than a specified number of investment options in an asset class (such as three). In those situations, examples of less than all options should be permitted, provided that the examples are chosen based on criteria that are fully disclosed in the educational materials.

In short, we would recommend that DOL adopt the first requirement, as modified in the prior paragraph, but not the second requirement.

IRAs. Based on the hearing, it was very unclear as to whether DOL would make changes to the definition of education in the context of IRAs, since there is not a plan fiduciary to screen investment options and present a limited menu of screened options.

If changes are not made to the definition of education with respect to IRAs, here is an example of what would be treated as fiduciary advice. A service provider tells an IRA owner that he should be 30% invested in large cap funds, based on his age and risk profile. The service provider then provides 20 examples of large cap funds based on some type of fully disclosed screening process, instead of leaving the IRA owner with the overwhelming task of sorting through perhaps more than 1,000 large cap options. This extremely helpful screening process would be treated as advice subject to the prohibited transaction rules, and thus this screening service would not be provided – a loss for IRA owners.

Accordingly, we urge you to apply the plan rule recommended above to IRAs also.

Facilitating small business plans.

As explained in detail in my July 21 comment letter, much concern has been expressed about the inability of financial institutions under the proposal to help small businesses set up retirement plans and select and monitor investment options for their employees due to the narrowness of both the seller's exception and the education rule. When this issue was raised at the hearing, DOL generally defended the provisions in the proposal, which are viewed in the industry as inadequate. The only mention of a solution by the DOL was a reference to the fact that the preamble to the proposal asked for comments on whether the best interest contract exemption ("BICE") should apply to advice for small businesses. Since the BICE is not workable, this is not a solution.

We urge you to revisit this issue and we offer our suggested fix, which is set forth in the Appendix to my July 21 comment letter.

Selling services.

Under the proposal, if a provider of investment services interviews to be hired by a small business or individual, that interaction would constitute fiduciary advice and a prohibited transaction. Or if such provider responds to a request for proposal issued by a small business or individual, any response would be fiduciary advice and a prohibited transaction. This is clearly not a workable rule.

Accordingly, we applaud DOL's announcement at the hearing that firms and advisors would be permitted to promote their own services without such promotion being treated as fiduciary advice. This is a major step forward. Our only input on this point is that any modification of the position announced by DOL at the hearing would present very significant problems from both a policy perspective and an Administrative Procedure Act perspective. DOL announced a rule change at the hearing prior to the close of the comment period; if DOL were to later modify the position announced at the hearing, the public would have relied on the announcement and thus would have been deprived of a meaningful opportunity to comment on the modified position.

Selling products.

At the hearing, DOL seemed committed to the idea that the seller's exception should not apply to selling assets to small businesses or individuals. The premise of this position appears to be that small businesses and individuals are not sophisticated enough to distinguish between selling and advising. This premise is mistaken in many respects. For example, if small businesses cannot distinguish selling from advising, they will not be in business very long. Business size is not a proxy for sophistication.

Moreover, DOL's position is inconsistent with the statute, which applies to advice but not to promotion, and with the way the commercial world functions. For example, an agent of an insurance company openly trying to sell an annuity – and not purporting to be an advisor -- is logically acting as a seller, not a fiduciary. DOL recognized this in 2010 but not in 2015.

We strongly urge you to go back to the very logical position set forth in the 2010 proposal. However, at a minimum, we would ask you to consider the following approach.

The selling of products can be divided into two steps. The first step is to agree with the customer about the framework under which advice will be given. For example, if an insurance agent is only selling annuities of one company, that agent needs to be able to establish that limitation on his or her services without triggering fiduciary obligations. But then any recommendation of a particular annuity would be subject to a best interest standard. In this context, the agent would not need to show that he or she considered any other types of investments, but would need to show that the recommendation of the particular annuity was in the customer's best interest.

The failure to take at least the approach described in the preceding paragraph would simply make the proposal so incompatible with the commercial world that compliance would be impossible, leading to widespread non-compliance and a resulting lack of respect for the law.

Platform exception.

Under the proposal, a recordkeeper can offer a menu of investment options for plan sponsors to choose from. For example, a recordkeeper may have 3,000 investment options from which a plan sponsor may choose the 10 or 15 to make available to the sponsor's employees. The offering of the 3,000 options is not treated as investment advice under the proposal's "platform exception," provided certain conditions are met. Many have asked for the platform exception to be expanded to cover IRAs. DOL appeared negative on this issue at the hearing.

DOL's position is clearly contrary to the needs of individuals. In the IRA context, firms provide limited menus for several reasons, including (1) to make the investment process less overwhelming for IRA owners, (2) to reflect screening processes and due diligence by the firms, and (3) to comply with FINRA and securities requirements. Why should this type of basic screening be treated as fiduciary advice? The DOL rule would effectively make this illegal, creating conflicts with other rules and depriving customers of a very helpful tool. In this way, the DOL proposal is decidedly harmful to IRA owners.

The DOL position not only hurts individuals, it also is unsound analytically. Unless the limited menu is presented as reflecting a set of recommendations, these limited menus are not advice, any more than the platforms offered by plan service providers are advice. The limited menu is simply what the firm offers to customers. If IRA owners want a different limited menu, the IRA owner can go to another firm. This is exactly like the sale of any product. For example, company X offers a certain type of widget for sale. If a customer wants a different type of widget, the customer can go to another company.

In effect, the DOL seems to broadly view individuals and small businesses as incapable of making very basic judgments and decisions, which they need to make in every aspect of their life. Individuals can make important decisions about where to live, what job to take, what house to buy, but they cannot be trusted with selecting an IRA provider with a limited menu of investments. This simply does not make sense.

Casual conversations as fiduciary advice. DOL indicated on several occasions during the hearing that casual conversations would not be treated as fiduciary advice under the proposal. DOL said that the definition of a recommendation was drawn from the FINRA definition, which involves a call to action. In fact, DOL made a point of saying that they will clarify in some way that they are using the FINRA definition.

- Under the proposal, however, the definition of a recommendation is not a call to action, but rather is "a communication that . . . would reasonably be viewed as a ***suggestion*** that the advice recipient engage in or refrain from taking a particular course of action" (emphasis added). There is nothing in this definition about a call to action. On the contrary, the definition is based on "suggestions," which certainly seem casual to me.
- Generally, in order for a recommendation to constitute fiduciary advice, the only other requirement is that the recommendation be rendered "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***" (emphasis added). Almost anything said or written is intended to be considered, so that this requirement does nothing to prevent casual conversations from becoming fiduciary advice.
- The fact that the definition of a recommendation does not involve a call to action is further illustrated by the fact that DOL has indicated both formally and informally that,

for instance, providing 20 examples – or even 100 examples -- of large cap funds would be treated as a recommendation when it is combined with education that the individual should be invested to a specified extent in large cap funds. Providing 20 examples (or 100 examples) of large cap funds can hardly be characterized as a call to action with respect to any security transaction.

DOL has repeatedly stated that to be fiduciary advice, there needs to be a "call to action." That concept does not show up anywhere in the proposal. If that is really what DOL means, that phrase should be included in the proposal as a requirement of fiduciary advice. If the rule is based on "suggestions" "for consideration," the rule will turn casual conversations into fiduciary advice.

Mutual understanding.

DOL on many occasions during the hearing made it clear that they do not think that the definition of fiduciary advice should require a mutual understanding that advice is being given. DOL asked: if a recommendation is made, why is a mutual understanding needed?

As discussed above, because of the way that the proposal defines a recommendation, mere suggestions can give rise to fiduciary status under the proposal. Something more is needed, preferably a mutual understanding. Or at least a rule under which an objective person would reasonably view the communication as advice intended to be relied upon.

Question often posed by DOL at the hearing.

On several occasions, DOL posed the following question. If DOL (1) applies the seller's exception to individuals and small businesses, (2) preserves investment education, and (3) includes a mutual understanding requirement, isn't that effectively the same as preserving the five-part test?

Briefly, the answer to DOL's question is no, it is not the same as preserving the five-part test. First, in 2010, DOL did numbers 1 and 2 above, and no one contended that that preserved the five-part test. Those are completely separate issues. So the only question is whether preservation of the mutual understanding requirement is effectively a preservation of the five-part test. My answer would be preservation of the mutual understanding requirement does not preserve the "regular basis" requirement, nor does it preserve the "primary basis" requirement. Since those were the main two objections to the five-part test, it seems clear that preservation of the mutual understanding requirement is not at all the equivalent of preserving the five-part test.

Interaction between basic definition and the carve-outs.

DOL indicated that it may need to clarify that the carve-outs are simply safe harbors. In other words, for example, the fact that education provided is not within the education carve-out does not mean that the education is fiduciary advice. Education that is not within the education carve-out may or may not be fiduciary advice, depending on whether the education otherwise falls within the definition of fiduciary advice, such as including a recommendation for consideration.

This clarification alone would help but it would not help a significant amount due to the extremely broad definition of a recommendation. If any suggestion directed to a recipient for consideration is fiduciary advice, almost everything is fiduciary advice.

"For a fee or other compensation" -- clarifications

Plan sponsor employees. At the hearing, DOL expressed openness to exploring what it means for advice to be provided "for a fee or other compensation." This is a very helpful development. Assume, for example, that a human resources employee of a plan sponsor is receiving his normal compensation in exchange for the performance of many duties, including helping 401(k) plan participants with plan issues. Assume further that the human resources employee gives advice to a participant about how to invest the assets in her plan account. DOL indicated at the hearing that such advice would not be for a fee, because the employee is only receiving his normal compensation.

We had not read the proposal in that way, in part because that interpretation is inconsistent with the special carve-out in the proposal for plan sponsor employees who provide advice to plan fiduciaries and only receive their normal compensation. If the positon DOL took at the hearing was correct, there would be no need for the employee carve-out, and there would certainly be no reason to limit that carve-out to advice provided to plan fiduciaries.

It would be very helpful for DOL to formally incorporate the position described in the second preceding paragraph into the rule.

Call center employees. At the hearing, DOL also indicated that call center employees who do not receive additional pay for advice or a referral of business may not be receiving a "fee or other compensation." It would be extremely helpful for this to be clarified formally in the proposal. But in order for this clarification to have any effect, the compensation received by the financial institution employing the call center employee must not trigger fiduciary status for the financial institution. If this second point is not included in the rule, then the clarification about the call center employee has no effect. In other words, if the call center employee suggests consideration of an investment offered by the financial institution, and the financial benefit flowing to the financial institution is a fee or other compensation so that the financial institution is a fiduciary, then the fact that the call center employee does not receive a fee or other compensation is not helpful.

"Fee or other compensation" – statutory authority.

The focus on the requirement that a fiduciary receive a fee or other compensation for her advice highlights a key area where DOL has clearly exceeded its statutory authority. The statute expressly requires, as condition of fiduciary status, that an advisor render investment advice for a "fee or other compensation, direct or indirect." Without any discussion or legal explanation, the proposal includes "brokerage fees" in the definition of "fee or other compensation, direct or indirect." The following examples illustrate the inconsistency between the proposal and the statute:

> **Example 1**: Customer A says to his broker/dealer, "I have $5,000 to contribute to my IRA. How should I invest it?" The broker/dealer recommends that Customer A invest in Fund XYZ. Customer A follows the recommendation and directs the broker/dealer to invest the money in Fund XYZ. In return, the broker/dealer receives $25 from a combination of marketing fees, shared service fees, and recordkeeping fees. The broker/dealer receives no separate or additional compensation for advising Customer A on how to invest the $5,000.
>
> **Example 2:** The broker/dealer provides the same advice as in Example 1, but Customer A does not follow the advice. The broker/dealer receives no compensation.
>
> **Example 3**: Customer B says to her broker/dealer, "I have $5,000 to contribute to my IRA. Please invest the $5,000 in Fund XYZ." The broker/dealer executes Customer B's request. In return, the broker/dealer receives $25 from a combination of marketing fees, shareholder servicing fees, and recordkeeping fees.

In Examples 1 and 2, the broker/dealer provides the exact same advice, but only gets paid in Example 1. Why? Because the broker/dealer is not paid anything for providing advice. The broker/dealer is paid exclusively for other services (including execution services), none of which is advice. That is why the broker/dealer is paid the exact same amount in Examples 1 and 3 (with the payment attributable to equal investments of $5,000 in Fund XYZ) but is paid nothing in Example 2. Thus, under the statute, it is simply not possible to treat the fees received by the broker/dealer as being for the advice, rendering the proposal inconsistent with the statute and thus outside DOL's authority to issue.

Our position in this regard is consistent with the fundamental notion of a broker/dealer, another issue not addressed by the DOL. Under section 202(a)(11) of the Investment Advisers Act of 1940, the term "investment adviser" does not include "any broker or dealer whose performance of such services is *solely incidental* to the conduct of his business as a broker or dealer and who *receives no special compensation therefor*" (emphasis added). Under this rule, if a broker/dealer were to receive compensation for advice, the broker/dealer would be required to be treated as an investment adviser. It is well settled law that brokerage fees for execution and other services are not compensation for advice. Yet the proposal ignores this settled point of law and the facts described above, and concludes that brokerage fees are compensation for advice. There is no legal basis for this conclusion, which is beyond the DOL's statutory authority.

"For a fee or other compensation" -- in the rollover context.

The DOL has proposed to define "fee or other compensation, direct or indirect" to mean "any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation *incident to the transaction in which the investment advice has been rendered or will be rendered*" (emphasis added). The italicized language is ambiguous, however, because it is unclear what "transaction" DOL is referring to. But DOL's intent seems clear in the rollover context. If an advisor advises a plan participant to roll over his 401(k) balance from his employer's plan to an IRA sponsored by the advisor, DOL's view implicitly seems to be that a single "transaction" has occurred such that if the advisor receives compensation with respect to the investment of the rollover proceeds, then the compensation requirement of the advice definition is satisfied with respect to the rollover itself. For example, if the advisor receives no compensation for the distribution from the 401(k) plan per se, or from the rollover to the IRA, but ultimately receives compensation from investment of the distribution proceeds in the rollover IRA, the advisor will, under the implicit DOL view, be considered to have provided fiduciary investment advice to take a distribution from the plan and roll over the distribution, as well as fiduciary advice to invest the proceeds in the IRA.

However, this scenario actually consists of four separate transactions: (1) a recommendation to hire the advisor to advise on the disposition of the plan account, (2) a recommendation to take a distribution, (3) a recommendation to roll over the distribution to an IRA, and (4) a recommendation to invest the rolled over amounts in the IRA. In that case, each of these separate transactions should be considered separately to determine if the advice is for a fee or other compensation and thus fiduciary advice. This is especially true with respect to the fourth transaction, since an advisor may well provide advice on the first three transactions and not provide advice on the fourth. There is no basis in the statute or in logic to aggregate two separate pieces of advice and treat them as a single piece of advice unless they are inextricably linked together. Since advice on the fourth transaction may or may not accompany advice on the first three transactions, there is no inextricable link. This is most clearly illustrated by the common situation where a participant rolls over to a provider's IRA, but does not retain the provider to provide advice on investments.

In the example above, here is how the four transactions should be treated:

- Advice on the first transaction is simply selling services, which DOL has recognized is not fiduciary advice, as discussed above.
- Advice on the second transaction is not fiduciary advice unless the advisor's employer receives compensation by reason of the distribution as a separate transaction.
- Advice on the third transaction is not fiduciary advice unless the advisor's employer receives compensation for the establishment of the IRA, which may or may not be the case.
- Advice on the fourth transaction is not fiduciary advice unless the advisor's employer receives compensation for that advice in accordance with the principles stated in the prior section of this letter.

DOL's intent to treat compensation for advice on the fourth transaction as compensation for the third transaction appears to reflect a policy decision by DOL that advice regarding whether a participant should roll over her assets is a fiduciary act, regardless of whether the advisor receives any fee or other compensation with respect to such advice. That decision is inconsistent with the statute and thus would require a statutory change.

Rather than seek such a statutory change, the DOL appears to take the position that compensation received with respect to separate advice – i.e., regarding how the IRA assets should be invested – is received in connection with the rollover advice. As noted, there is no legal basis to aggregate the rollover transaction and the investment transaction. For example, what would be the DOL's analysis if the participant managed his own assets in the IRA for a couple of years? In that case, would the rollover advice not be fiduciary advice, if the advisor does not receive any other compensation for the rollover? What if the participant makes all initial investment decisions in the IRA and then subsequently asks the advisor for help? Again, would that mean that the rollover advice is not fiduciary advice?

In short, DOL's treating compensation for investment advice as compensation for rollover advice is not consistent with the statute and cannot stand up to scrutiny.

Valuation of assets.

At the hearing, DOL seemed generally wedded to its position that asset valuations "in connection with" a transaction are fiduciary advice, except in the case of ESOPs. There does not appear to be any policy or statutory basis for this nor any economic justification for a position that would trigger a significant amount of cost, uncertainty, and disruption. For example, standard valuations of insurance products in connection with plan purchases or distributions would become fiduciary advice, triggering very difficult fiduciary issues and potential prohibited transactions for the insurer that would be asked to value its own product.

BICE ISSUES

Scope of "Retirement Investors"

Under the proposal, the BICE is limited to advice provided to individuals and to non-participant-directed plans. We see no reason not to apply the BICE to advice provided to any recipient.

Rollover advice.

As it has on previous occasions, DOL stated at the hearing that advice regarding rollovers would be covered by the BICE. We have three comments in this regard.

- First, as currently written, the BICE does not appear to cover advice given to roll over assets, separate and apart from any decisions regarding plan investments. So if rollovers are covered by the BICE, that would need to be explicitly made clear.
- Second, the BICE disclosures and rules are all structured to relate to asset transactions, not advice separate from asset transactions, such as advice to roll over assets. So if rollovers are to be covered by the BICE, an entire new structure is needed in the BICE.
- Third, unless the BICE is radically altered to be made workable, in the manner suggested in my July 21 comment letter, it does not matter what the BICE applies to, since to my knowledge no one will use it, as discussed below.

Applicability of the BICE to other retirement services.

Currently, the BICE appears to apply to advice regarding assets but not to advice regarding services (such as recommending an investment manager or a managed account program). To my knowledge, this issue was not discussed by DOL. This issue needs to be addressed, and the BICE requirements need to be modified to address advice regarding services.

Arbitration.

The BICE does not currently prohibit mandatory arbitration of individual claims (though it does prohibit mandatory arbitration of class actions). It was clear from the hearing that DOL is reexamining whether the current industry arbitration procedures are appropriate in the context of individual claims under the BICE, or whether a different system should be explored for individual claims under the BICE that makes it easier for individuals to prevail.

We will be brief. Right now, to my knowledge, no one is planning to use the BICE, except a very small number that are considering possibly using it, but that could not use it in a timely manner unless the eight-month transition were extended in a major way. The reasons include: too much cost, too much liability, and too little time. If the arbitration rules are modified to create more cost and more liability, that would further cement the existing decisions not to use the BICE. And if firms do not use the BICE, the result will be elimination of services to small accounts and small businesses. In other words, modifying the arbitration rules would simply make an unworkable rule even more unworkable.

In this regard, we reiterate a point made in my July 21 comment letter. The DOL Regulatory Impact Analysis ("DRIA") never evaluated the workability of the BICE, a serious deficiency in the DRIA. An evaluation of the workability of the BICE would reveal that it is unworkable and that adverse changes to the arbitration rule would make it even more unworkable.

BICE disclosure.

DOL said at the hearing that it was open to possibly simplifying the disclosure requirements, but very few details were provided. One detail was that, for purposes of the one, five, and 10-year projections, DOL might provide standardized assumptions to make the projections. But DOL did not signal that it might back off of the requirements that the projections (1) be made at the point of sale and (2) be individualized. Thus, with respect to this aspect of the BICE, the change being contemplated is not sufficient.

Furthermore, to my knowledge, there was no meaningful discussion of the requirements (1) to provide an enormously complex webpage, (2) to provide the dollar amount of indirect compensation on account level, or (3) to report a massive amount of information to the DOL (and others). Without very significant changes to these rules, the BICE will not be used, as discussed above.

BICE contract: in general.

At the hearing, DOL seemed wedded to requiring a contract under the BICE, instead of the more logical and statutorily sound approach of simply treating all the substantive BICE requirements, such as the best interest requirement, as conditions of the exemption. We urge you to revisit this decision, since there are many financial institutions that will feel compelled to cease serving small accounts due to the potential liability of being subject to state law class actions on amorphous best interest claims.

BICE contract: timing and signatures.

For purposes of discussion, we assume that DOL decides not to follow our recommendation that the contract requirement be deleted.

- **Existing customers.** At the hearing, DOL seemed open to not requiring signatures from existing customers, but rather, for example, permitting the use of "negative consent," i.e., the contract will go into effect unless the customer receiving it objects to it going into effect. This would be helpful.
- **New customers.** DOL seemed open to having the contract signed upon the client agreeing to the engagement with the advisor, as long as the contract is retroactively effective to apply to the pre-contract discussions.
    - **Flaw in the new customer approach.** It was pointed out at the hearing that this does not work in many situations**.** For example, an IRA owner may seek advice from mutual fund family X about a particular fund that X offers, but then the IRA owner may buy that fund through an unrelated brokerage firm, so the IRA owner gets advice from X but never agrees to an engagement with X. A unilateral contract with all persons who contact X would address this problem.
- **Contract with which persons.**
    - At the hearing, DOL raised the possibility of permitting a plan sponsor to enter into a contract on behalf of plan participants so that every participant need not enter into a contract. This would be helpful. A contrary rule would simply be unworkable. Please note that even this may not work in some cases, especially in the case of participants who use a brokerage window and thus do not deal with the plan's main service provider.
    - The proposal requires individual advisors to sign contracts with customers, which is not workable because of (1) turnover among advisors, (2) a customer's main advisor may be busy or out of the office when the customer calls, requiring a contract with other advisors, and (3) in the case of call centers, any representative may pick up the phone. DOL seemed to recognize the third problem at the hearing. All three situations would need to be addressed.

Incentives.

In general. At the hearing, DOL seemed committed to the BICE requirement that the financial institution warrant that it does not provide incentives for advisors not to act in the best interest of the customer. Under the proposal, this requires having level fees at the advisor level, unless a financial institution can justify non-level fees based on "reasonable and objective neutral factors," such as the time and expertise needed to provide prudent advice on a product.

This requirement simply does not work in its current form. There are many variations in advisor pay from product to product, based on a variety of important business factors, including the difficulty involved in selling a product and the fact that certain products are sold to be held indefinitely. But there is no way to equate the compensation variations in any precise way to any factor. For example, in order to feel comfortable that the BICE has been satisfied, the financial institution would have to feel reasonably certain about (1) how much extra time and expertise is required to sell a product and (2) how to translate that extra time and expertise into a precise amount of extra compensation. In the absence of any guidance on this issue at all, there is no way for any financial institution to feel comfortable that any variation in compensation is permissible.

Solution. We see no reason for this level-fee requirement in light of the existing Code and ERISA prohibited transaction rules requiring only reasonable compensation to be paid to service providers, which would include the advisor. If the advisor is only receiving reasonable pay, then by definition the pay is commensurate with the time and expertise needed. If the pay was disproportionately large compared to the time and expertise needed, the pay would not be reasonable. The reason that the current law rule is workable and the new rule is not is that under current law, the determination of whether pay is reasonable can be based on commercial reasonableness, rather than based on the type of mechanical factors set forth in the proposal. So the solution here is straightforward: rely on the current law reasonable compensation rule, which serves the same purpose, but does so in a workable manner.

Definition of best interest.

Concerns have been expressed about the language in the BICE that indicates that under the best interest standard, advice must be provided "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." The concerns have been that this could preclude an advisor from being compensated, even if the advice is in the customer's best interest. DOL indicated at the hearing that they viewed the quoted language as simply the equivalent of the statutory language in ERISA section 404, which requires fiduciary duties to be carried out "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose of providing benefits to participants and beneficiaries" and defraying plan expenses.

If the DOL goes in this direction, it would help to have an explicit recognition that the standard would not be violated by (1) limiting advice to a subset of products, some or all of which are proprietary, or (2) the receipt of variable compensation. Arguably, #1 is already addressed in the BICE and #2 is implicitly addressed, but it would help to make this explicit.

HEALTH AND WELFARE PLANS

DOL stated that the proposal does not apply to health and welfare plans that do not have an investment component (referred to here as "unfunded health and welfare plans"). We appreciate this statement. However, most of the industry does not agree with DOL's interpretation of the words of the proposal. Since it is the words of the proposal that would be used in litigation with participants in unfunded health and welfare plans, we ask that the inapplicability to unfunded health and welfare plans be made explicit. Reliance on the current words of the proposal would not work for the reasons set forth in my July 21 comment letter.

APPLICABILITY DATE

It is clear that the eight-month transition period is not workable. No major financial institution can be in compliance in eight months, even with the basic definition. So if that period is retained, there will be widespread non-compliance and confusion, causing severe harm to individuals trying to save for retirement. To my knowledge, no defense was offered at the hearing for this unrealistic deadline. As far as we can understand, the only explanation for this unrealistically short and harmful transition period is a political reason, i.e., so that the final rule can be made effective before the change in Administrations in January of 2017. There needs to be a three-year transition period.

GRANDFATHER RULES

DOL indicated that they are considering a range of different grandfather rules, exempting certain investments or advice from the new rules. But DOL did not provide any specifics regarding what they were contemplating. We reiterate our requests for appropriate grandfather rules regarding the proposal, including (1) a provision under which the proposal would not apply to any advice provided prior to the applicability date, nor to any direct or indirect fees or other compensation received in connection with such advice, (2) a provision under which the proposal would not apply to any advice provided after the applicability date to the extent that such advice gives rise only to any compensation that would have been paid without regard to the advice, and (3) a provision under which the proposal would not apply to advice that was pre-paid for prior to the applicability date.

STATUTORY AUTHORITY

In my letter of July 21 and above in this letter, we point out that there are a number of instances where DOL has gone clearly beyond its statutory authority. In this regard, we are very troubled by a foreshadowing of DOL's intent to go beyond its statutory authority and attempt to effectuate policy changes that are exclusively within Congress' purview. In a BNA article dated September 9, 2014 by Kristen Ricaurte Knebel, DOL appears to be stating very broadly, not tied to any specific project, that the agencies need to be the ones to make social and legal change happen, rather than Congress. Specifically, the article includes the following:[1]

- "[The Assistant Secretary of Labor for EBSA] said the most significant development over the past 40 years might be the shift from modifying a law with legislation, to modifying a law with regulation and litigation."
- "'*Today, you can't get Congress to pass a Mother's Day resolution*,' [the Assistant Secretary] said. '*So what we've done is we've shifted from the way that social change and*

[1] In some cases the article describes what was said; in other cases, the article presents actual quotes. The actual quotes are presented above in italics.

legal change and financial change is accomplished through congressional action to two different avenues for making changes: The main one being regulation and the second one being legislation,' [the Assistant Secretary] said."

- "One advantage of regulation is that the agencies writing the rules are able to receive input from the public, something that doesn't often happen with Congress, [the Assistant Secretary] said."
- "*'Legislation is a blunt instrument for sure, but believe me, litigation is not a great instrument either. I used to tell my law students when I taught my ERISA class that when you came to litigation, that was an abject failure of the system because it represented the biggest amount of miscommunication that you could possibly imagine*," [the Assistant Secretary] said.*'*"

This marks at least the second time this type of point has been made by the DOL. In a May 1, 2012 BNA article by Florence Olsen, the Assistant Secretary was cited as having expressed skepticism that Congress would address an issue, and the Assistant Secretary was quoted as stating *"It's hard to imagine passing a Mother's Day resolution in this Congress".*

To the extent that these quotes are accurate or even close to being accurate (and there is no indication at all that they are not accurate), it would suggest that DOL views itself as stepping into Congress' shoes in making policy. We urge DOL to return to its proper role as an interpreter of the law, not a maker of new law and new policy.

<u>ECONOMIC ANALYSIS ISSUES</u>

<u>United Kingdom experience as a lesson for this issue.</u>

On August 3, 2015, the United Kingdom government initiated a review of the extent to which investment advice for holders of accounts with small balances is being diminished following a 2013 rule change that has an effect identical to what the DOL is proposing. DOL has consistently denied what is now widely accepted in the U.K., i.e., that, following a 2013 rule change, middle- and lower-income savers in the U.K. are being cut off from investment advice. Yet this move by the U.K. government signals that the advice gap for individuals with the greatest need to save has become a major concern.

<u>The specific issue.</u> The DOL's proposed fiduciary definition rule would have the effect of banning third-party payments to advisors. The reason that this is true is that the only way for an advisor to accept such payments is to use the proposed BICE, which to my knowledge no financial institution can or will use, as discussed above.

Effective January 1, 2013, the U.K. adopted a rule directly banning such third-party payments to advisors, i.e., the U.K. rule has exactly the same effect as the DOL proposal. The U.K. rule triggered a massive exodus of advisors from the small account market in the U.K., as documented below.

DOL has strongly contended that the U.K. rule has not created an advice gap for small savers. ***However, as of August 3, 2015, the U.K. has launched a major review of exactly that advice gap.***

Critical need for change to DOL proposal. It is critical that the DOL alter the provisions in its proposal that would have the same unintended effect on savers with low account balances in the U.S. as the rule change in the U.K. has had on low-balance savers there. Specifically, that would mean making DOL's proposed BICE workable.

DOL's position. In its economic analysis of its proposed rule, DOL maintained that "there is little evidence that investment advice has decreased significantly" in the U.K. DOL goes on at great lengths to paint a very favorable picture of the U.K. experience[2]:

> For example, concerns also were expressed about the establishment of an "advice gap" for those with small amounts to invest.70 However, in July 2013, the FCA announced that six months after the effective date of the RDR, 97 percent of current advisers had attained the appropriate level of qualification. The remaining three percent were recent market entrants who are still studying within the timelines allowed by the RDR. Also, according to the FCA letter, a substantial decrease in the number of financial advisers did not occur. By the end of 2012, the number of advisers went from 35,000 to 32,100, a decline or less than 10 percent, which was in line with the FCA's expectations. The FCA has indicated that there are currently 31,500 advisers as of October 2014. External consultants to the FCA, Europe Economics, issued in December 2014 an independent post RDR review, which found that there is little evidence that investment advice has significantly decreased, with the majority of existing advisers willing and able to take on more clients. According to this report, it appears that in the year ending March 31, 2014 advisers dropped about 310,000 clients who whom they no longer found profitable to serve. On the other hand 820,000 clients were gained in the same period. According to the authors, the net increase in customers served suggests that dropped clients who looked for replacement advisers were largely successful.
>
> Related to this report, the FCA also commissioned research with Towers Watson to also address whether there is an investment advice gap between demand for investment advice and capacity to meet that demand. In December 2014 report, Towers Watson concludes that there is not an advice gap because there are sufficient advisers to meet the demand (approximately 30,000 advisers compared to the estimated 25,000 required to meet the demand).

Moreover, in July, Secretary Perez testified on the DOL proposal and responded to a question from Senator Cassidy regarding the U.K. situation:

[2] Please see my July 21 comment letter for a refutation of DOL's specific discussion below, which paints a favorable picture based on points that are not relevant and on arguments that omit critical facts. The reason for including the quote in the text is simply to illustrate the extent to which DOL has asserted that the U.K. rule is working well, an assertion that even the U.K. government now admits is wrong.

Senator Cassidy: I am told that United Kingdom put in laws similar to this in 2013 and that banks stopped offering investment advice to customers with less than 80K in assets. Now that, you know, may be that the answer to Senator Warren's question is that this model worked for those lower and moderate income people, or at least those with moderate assets. So just comment on that. Again, I don't know whether it is true or not – just your thoughts on that.

Secretary Perez: It's not true, and let me give you the facts. After the U.K. put in place their regulation – and by the way, their regulation bans commissions, we don't ban commissions – there were – advisors dropped 310,000 clients and 820,000 new clients came into the market so there was a net delta increase after the regulation of over half a million.[3]

Investors with low balance accounts continued to be served – because you were concerned about that. And, here's the most interesting data point about the U.K. – and I traveled there personally to meet with them because I heard that feedback a lot – the most interesting point about what happened in the U.K., Senator, is that more and more people are now getting in lower cost funds. . . . So the U.K. experience, I welcome further inquiry into it because there's been a fair amount of incorrect information surrounding it.

Facts from the U.K. Here are the facts from the U.K.:

- ***Outgoing head of the U.K. regulator (the "FCA") that instituted the 2013 rule admits that there is an advice gap.*** Martin Wheatley, the head of the FCA, is stepping down from his position this month after his contract was not renewed. In late July, Wheatley reportedly was asked what the most significant outstanding issue for the FCA was. He responded that more needs to be done to address the financial "advice gap" for those with less complex advice needs. Wheatley stated:

  > The gap is for the relatively smaller sized pots, as to whether – with all the liability that comes with giving advice – there is enough provision of service for those with simpler needs and less to invest. That's the gap which we are committed to doing some more work on.

- ***As of August 3, 2015, the U.K government launched a broad new review focusing on "the advice gap for those people who want to work hard, do the right thing and get on in life but do not have significant wealth."*** This major review was launched by the Economic Secretary to the Treasury and will be led by the new interim head of the FCA. The object is to put forth a package of reforms.

[3] According to a U.K. study, there are enough advisors to serve all potential customers. But this study, *commissioned by the U.K. regulator itself,* makes two key points. First, the study concludes that there is insufficient data to conclude that small accounts are receiving needed advice. Second, however, the study states that anecdotal evidence suggests that the large number of advisors for the *entire market* does not help the small savers, where the availability of advice appears to have been reduced. See also the discussion below of the fact that two-thirds of advisors refuse to serve accounts under $31,200. [This note is not part of the Secretary's quote.]

  - Widely accepted data ***acknowledged by the DOL itself*** shows that roughly two-thirds of U.K. advisors refuse to provide services to individuals with less than $31,200 in savings (the 2015 equivalent of £20,000).

- ***As noted, the DOL proposal effectively bans all third-party payments to advisors (referred to in the U.K. as commissions, which is why the Secretary referred to commissions in the above quote)***. Under the DOL proposal, third-party payments to advisors are generally only permitted under the BICE. Since no financial institution that I am aware of can use that exemption, as discussed above, the DOL proposal effectively bans such payments, just like the U.K. rule.

- ***Facts about the $80,000 figure that Senator Cassidy asked about:*** In anticipation of the new U.K. rule, the following practices were adopted:

  - **U.K.'s "big four" banks (an important source of investment advice in the U.K).**
    - **HSBC:** provided investment advice only for customers with at least $80,000[4] in total assets or $160,000 of annual income.
    - **Lloyds:** provided face-to-face investment advice only for customers with at least $160,000 in assets.
    - **Royal Bank of Scotland:** charged $800 to set up a financial plan, and made changes to gear investment advice services to high net-worth clients.
    - **Barclays:** provided investment advice only for customers with at least $800,000 in assets.
  - **Examples of other actions taken.**
    - **Aviva:** ceased offering face-to-face investment advice.
    - **AXA:** ceased offering face-to-face investment advice.
    - **Advisor firm AWD Chase de Vere:** stopped accepting clients with $80,000 or less in assets.
    - **Advisor firm Towry:** stopped accepting clients with less than $160,000 in assets.

Even after the U.K. has admitted there is a problem, DOL continues to deny it. In late August, DOL released a new study purporting to support its proposal. Burke and Hung, *Financial Advice Markets: A Cross Country Comparison,* RAND Labor and Population (April 21, 2015) ("Burke/Hung"). The study was prepared before the U.K. announced its major review of the advice gap, but DOL still released the study without any caveats or even recognition of this major flaw in the study, which is very troubling. The report predictably concludes that the advice gap is small, which is inconsistent with the facts, as recognized by the U.K. government itself.

Supplemental research released by DOL.

[4] The dollar references in this part of the document are based on 2013 pound to dollar conversion rates.

In addition to Burke/Hung, DOL released two other research papers in late August and one in September: Hung, Gong, and Burke, *Effective Disclosures in Financial Decisionmaking*, RAND Labor and Population (July, 2015) ("Hung/Gong/Burke"); Panis, *Comments on a Review of a White House Report on Conflicted Advice,* Advanced Analytical Consulting Group, Inc. (August 21, 2015) ("Panis"); and Burke and Hung, *Do Financial Advisers Influence Savings Behavior?* RAND Labor and Population (August, 2015) ("Burke/Hung II").

Hung/Gong/Burke questions the effectiveness of disclosure of conflicts of interest, and then emphasizes very strongly that to be effective, disclosure must be simple and short:

> The trends in regulation on disclosure in [financial] areas have all focused on simplifying disclosures. Research has shown that the longer, more detailed disclosure documents have not been effective at helping consumers make informed choices . . . .

Hung/Gong/Burke at 24. There is a striking inconsistency between this analysis and the proposal, which requires extremely detailed lengthy disclosures.

Panis unfortunately seems to be structured as a brief, rather than as a balanced study reflecting an objective analysis of the facts. For example:

- Panis attempts to refute the existence of an advice gap in the United Kingdom without ever acknowledging that the U.K. government itself has launched a major review of a gap that Panis says does not exist.
- Panis states that "the academic literature offers little or no quantitative estimates of the benefits of broker advice." Again, Panis just overlooks a very recent authority, an entire study dedicated exclusively to that question – the 2015 Oliver Wyman study.

Burke/Hung II examines the issues underlying the findings that individuals who consult financial advisors have higher level of savings. The issue being examined is whether the higher levels of savings are attributable to the assistance provided by financial advisors or whether individuals who have higher level of savings and are more inclined to save are the ones who consult financial advisors. The authors conclude that "few papers attempt to address" this issue, and that "much of [the] work is correlational and unable to establish whether advisers are causing improvements in retirement-planning outcomes. . . ." In short, the authors conclude that there is no answer to the question of whether financial advisors improve savings results.

So in its economic analysis, DOL does not take into account any benefits of financial advice. To back up its conclusion, it appears that the best that DOL can do is to release the Burke/Hung II study, which concludes that it is unclear if financial advisors produce benefits for savers. This is extremely troubling – a core element of the DOL analysis is completely unsupported. If this core element of the DOL analysis has no support, DOL's entire economic analysis falls apart.

<u>Continued omissions from DOL's economic analysis.</u>

DOL continues to move forward with the proposal despite having gaps in its economic analysis. Secretary Perez announced before the hearing and before the beginning of the second comment period that DOL would not re-propose, but would go straight to a final regulation. This announcement effectively indicated that comments were not necessary in deciding whether significant changes to the proposal were needed. Please see my letter of September 9 in this regard.

This political decision is consistent with what has happened with respect to the economic analysis. As noted, DOL has released four more studies to support its proposal. None of the studies addresses the following significant gaps in the economic analysis described in more detail in my July 21 comment letter. Here is a list of those unaddressed gaps:

- A Quantria Strategies, LLC study estimating that the proposal would cause lost retirement savings of $68-80 billion annually.
- A Quantria study demonstrating the lack of foundation for the DOL's estimate of the cost of conflicted advice.
- A 2011 DOL study estimating that the prohibited transaction rules are at least partially responsible for over $100 billion of losses each year, yet the DOL would massively expand those rules in its proposal.
- No analysis of the sufficiency of the eight-month transition period.
- A vastly erroneous estimate of the IT costs of complying with the BICE. In this regard, the answer to Mr. Piacentini's question about the Quantria study -- set forth in his letter to me dated August 26, 2015 -- is contained in my July 21 letter, which states as follows:
    - "I asked major financial institutions about the number of hours and amount of money that they spent on implementing a far less burdensome set of DOL disclosure requirements: the participant disclosure rules under Regulation § 2550.404a-5 and the service provider disclosure rules under § 2550.408b-2. Here are the answers I received:
        - One company spent over 100,000 IT hours implementing the two existing requirements at a cost of approximately $8.4 million.
        - Another company spent over 90,000 hours at a cost of over $6.5 million."
    - My request described in the sub-bullet above was sent to 12 major financial institutions. As noted in my July 21 letter and in the Quantria study, two responses were received.
    - Regarding the other questions posed to me in Mr. Piacentini's letter of August 26 regarding the 2015 Oliver Wyman study, I previously responded to Mr. Piacentini by e-mail. My e-mails stated that "with respect to the Oliver Wyman report, Davis & Harman did not retain Oliver Wyman to conduct this report. While we represent one or more of the companies that sponsored the report, there are other sponsoring companies that we do not represent. Accordingly, Davis & Harman is not currently authorized to respond regarding the Oliver Wyman report."
- An unfounded assumption that all contracts under the BICE can be executed during the eight-month transition period.
- A lack of any analysis of the workability of the BICE.
- An erroneous analysis of the effect of the proposal on call centers.

- The conflict between (a) the analysis in the preamble stating that disclosures are "meaningless" and "ineffective" and (b) the fact that the BICE requires more disclosure than any other retirement regulation or statute, at least in recent history.
- An erroneous analysis of the 2011 Oliver Wyman study.
- The omission from DOL's discussion of its own sponsored studies that do not support DOL's proposal.
- An ineffective attempt to refute the troubling findings of the Greenwald & Associates small business survey.
- An ineffective attempt to refute the analysis in the 2014 Quantria study.
- A failure to address the very troubling analysis in the GAO's 2013 report on distribution issues.
- The failure of DOL to do any economic analysis of the effects of the major cutback in investment education included in the proposal.
- The lack of any analysis of the harmful effects of the inconsistency between the proposal and other rules applicable to retail accounts.
- DOL's failure to disclose the input DOL received from the SEC.

Thank you for your consideration of the views expressed in this letter.

Sincerely,

Kent A. Mason