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July 20, 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, Definition of the Term Fiduciary — Conflict of Interest Rule — Retirement Investment Advice — Exemptions

Via: e-ORI@dol.gov.

Introduction

I am pleased to provide these comments on the proposed rules regarding the definition of the term fiduciary, conflict of interest, retirement investment advice and various exemptions. Specifically, these comments are directed at the following seven proposed rules.

1. RIN 1210–AB32 "Definition of the Term 'Fiduciary'; Conflict of Interest Rule — Retirement Investment Advice" (34 pages).
2. ZRIN 1210–ZA25 "Proposed Best Interest Contract Exemption" (30 pages)
3. ZRIN 1210–ZA25 "Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs" (16 pages).
4. ZRIN 1210–ZA25 "Proposed Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks" (7 pages).
5. ZRIN 1210–ZA25 "Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks" (15 pages).

6. ZRIN 1210–ZA25 “Proposed Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1” (8 pages).
7. ZRIN: 1210–ZA25 “Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters” (11 pages).

Together these rules comprise 121 pages of small type in the *Federal Register*. They are complex and raise complex issues relating to the approximately $14 trillion dollars held in defined contribution plans and individual retirement plans in 2014.[1] It is no wonder that the overwhelming consensus of the many comments filed so far is that the public needs more time to fully understand the implications of the rules and to provide meaningful comment to the Department. The Department should further extend the comment period.

The proposed rules would alter the regulations governing who is deemed to be rendering “investment advice for a fee or other compensation” within the meaning of ERISA section 3(21)(A)(ii)[2] and Internal Revenue Code section 4975(e)(3)(B) and therefore deemed a fiduciary. It substantially broadens the class of persons who would be deemed a fiduciary compared to present law.[3] In general, under the proposed rules persons who provide investment advice pursuant to an agreement, arrangement, or understanding that the advice is individualized or specifically directed to the recipient for consideration in making investment or investment management decisions regarding plan assets would be deemed a fiduciary. Various limited exemptions are provided.

The Problem Being Addressed

The proposed rules are directed at a legitimate problem. However, the rules define the problem incorrectly. Moreover, the contemplated rules are both extraordinarily overbroad and economically counterproductive. In their current form, they will harm the investing public, small business, the securities industry and those working in the industry and the economy.

The problem, properly defined, is that those selling investments or providing investment advice to consumers and small businesses for retirement plans often imply to varying degrees -- or forthrightly state -- that they are looking out for the “best interests” of the investor when in fact they are not doing so. As discussed in detail below, there is a relatively simple means to remedy this problem. The Department could (1) require, in an efficacious manner, that consumers be made aware whether the person selling investments or providing investment advice is, or is not, in fact obligated to “look out for their best interests” and (2) enforce, in conjunction with other relevant agencies,[4] the existing anti-fraud rules. Or, in a more legalistic formulation, those selling investments or providing investment advice should be required to fully and efficaciously disclose

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[1] See Federal Reserve, Financial Accounts of the United States, Z.1 Release L.117, Private and Public Pension Funds, June 11, 2015, p. 93 http://www.federalreserve.gov/releases/z1/Current/z1r-4.pdf.
[2] 29 U.S. Code §1002(21)(A)(ii).
[3] 29 CFR §2510.3–21 — Definition of “Fiduciary.”
[4] These would include the SEC, FINRA, the IRS and state tax, securities and insurance regulators – all of whom have a role in enforcing anti-fraud statutes with respect to securities transactions in ERISA plans.

whether or not they stand in a fiduciary relationship to the investor and the existing anti-fraud laws should be enforced to the extent those selling investments or providing investment advice misrepresent their status.

A transaction induced by fraud (misrepresentation) is not voluntary or welfare enhancing in that it would not be entered into in the absence of the fraud (or would be entered into at a different price). To the extent that those giving investment advice or making securities sales affirmatively state that they are looking out for the "best interests" of the investor when in fact they are not doing so, such representations are fraudulent. Such misrepresentations are unlawful under current federal and states securities laws and would constitute a common law tort.[5] Material omissions also are barred. Moreover, failure to disclose information is also often deemed culpable and would give rise to liability under the securities laws and the common law.[6] Addressing these sorts of problems does not require an additional rule. It simply requires the enforcement of existing laws.

Suitability Requirement Already Exist and Are Relatively New

Critically, broker-dealers and registered representatives (including insurance agents selling investment products) must already comply with FINRA Rule 2111 relating to suitability. That rules provides that:

> A member or an associated person *must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer*, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, *the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance*, and any other information the customer may disclose to the member or associated person in connection with such recommendation.[7] (emphasis added)

The rule, its supplementary material and additional FINRA guidance then provide detailed guidance about how to implement this requirement.[8] This rule provides a high degree of protection to investors although it imposes fewer duties on broker-dealers and registered representatives than would a fiduciary duty. It also entails less litigation risk and regulatory risk

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[5] See, e.g., Securities Exchange Act of 1934 section 10(b) [15 U.S. Code § 78j] (relating to federal securities misrepresentation); Section 501 of the Uniform Securities Act (2002) (relating to state securities misrepresentation) http://www.uniformlaws.org/shared/docs/securities/securities_final_05.pdf; §525 Liability for Fraudulent Misrepresentation, §526 Conditions Under Which Misrepresentation Is Fraudulent (Scienter) and, especially, § 529 Representation Misleading Because Incomplete and §551 Liability for Nondisclosure, *Restatement of the Law, Second, Torts, Volume 3* (American Law Institute: 1977) (relating to common law misrepresentation torts).
[6] Ibid.
[7] FINRA Rule 2111 Suitability http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859&print=1.
[8] FINRA Rule 2111 (Suitability) FAQ http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq .

than does a fiduciary duty. Failure to comply with Rule 2111 will result in sanctions and can result in the individual or firm in question being barred from the securities industry.

FINRA Rule 2111, although of substantial importance, is relatively recent, having taken effect only three years ago in July 2012. Its economic impact is not clear. One thing is clear. The overwhelming majority of the economic research relied up by the Department[9] and by the Council of Economic Advisors in its report[10] predates the application of Rule 2111 and is, therefore, largely irrelevant. Investment sales practices have substantially changed. The CEA's "finding" that "conflicted advice leads to losses totaling about $17 billion every year for IRA investors" is equally invalid.[11] The CEA report was cited by Labor Secretary Perez[12] and the Department in support of the proposed rules.

Multiple Standards and The Securities and Exchange Commission Initiative

The Securities and Exchange Commission (SEC) is also examining this issue. The SEC staff released a study that found:

> … that investment advisers and broker-dealers are regulated extensively under different regulatory regimes. But, many retail investors do not understand and are confused by the roles played by investment advisers and broker-dealers. The study finds that "many investors are also confused by the standards of care that apply to investment advisers and broker-dealers" when providing personalized investment advice about securities.[13]

This rule will exacerbate this confusion by establishing yet another standard and increase the already extensive regulation of investment advisers and broker-dealers. It is not at all clear how the DOL ERISA fiduciary standard would interact with the various other FINRA, SEC and state standards relating to broker-dealers, registered representatives, investment advisors and insurance agents. Nor is it clear how the proposed rules will interact with the "uniform standards" that the SEC is likely to propose soon.

One thing that is clear is that the proposed rules will disproportionately harm small firms in the securities business and lead to a further concentration in the industry. This is because the cost of regulatory compliance does not vary linearly with firm size but instead constitutes a much higher share of small firm gross revenues and has, therefore, a disproportionate adverse impact on small

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[9] See list of studies at Fiduciary Investment Advice, Regulatory Impact Analysis, April 14, 2015 http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[10] "The Effects of Conflicted Investment Advice on Retirement Savings," February 2015, pp. 95-96 https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[11] Ibid.

[12] Statement of Thomas E. Perez, Secretary of Labor, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, U.S. House of Representatives, June 17, 2015 http://www.dol.gov/ebsa/newsroom/ty061715.html.

[13] "SEC Releases Staff Study Recommending a Uniform Fiduciary Standard of Conduct for Broker-Dealers and Investment Advisers," https://www.sec.gov/news/press/2011/2011-20.htm; "Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," Staff of the U.S. Securities and Exchange Commission, January 2011 https://www.sec.gov/news/studies/2011/913studyfinal.pdf.

firm profitability. Some large firm managers are quite blunt about how the tsunami of financial regulation serves as a barrier to entry and impedes competition from small, disruptive rivals.[14]

The Ethics of the Situation

If the "investor advisor,"[15] broker-dealer, registered representative or insurance agent makes it clear to the investor that the investor advisor, broker-dealer, registered representative or insurance agent is not looking out for the "best interests" of the investor, then both parties should be free to move forward. In a free society, it is inappropriate paternalism for the government to prevent people from making the investments that they judge to be good investment opportunities or that they may choose to invest in for reasons other than pecuniary gain such as a personal relationship or affinity for the mission of the enterprise. Providing that the seller of the investment or advice is honest about their duties or lack thereof toward the investor, the investor should be entitled to choose that investment product or make that investment. Similarly, the government should not *force* investors to be subject to the opinions or judgment of fiduciaries about what is or is not good for the investor if an investor disagrees. Fiduciaries will often be quite cautious in their investment advice and bar investors from making certain investments since the fiduciary will be second guessed by regulators in the proposed regime. Citizens, not government or government designees (i.e. the new fiduciaries), should be the judge of what is in their interest.

A Better Approach

A much better approach to the problem has been outlined by New York City Comptroller Scott M. Stringer. His proposal, now being considered by the New York legislature, would require non-fiduciaries to confirm *both aloud and in writing* that:

> I am not a fiduciary. Therefore, I am not required to act in your best interests, and am allowed to recommend investments that may earn higher fees for me or my firm, even if those investments may not have the best combination of fees, risks, and expected returns for you.[16]

Such an approach would ensure that investors understood that non-fiduciaries are not required to act in the investor's best interest but are salespersons. This would inform investors about who

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[14] Goldman Sachs CEO Lloyd Blankfein, for example, recently said "More intense regulatory and technology requirements have raised the barriers to entry higher than at any other time in modern history. This is an expensive business to be in, if you don't have the market share in scale. Consider the numerous business exits that have been announced by our peers as they reassessed their competitive positioning and relative returns." "Regulation Is Good for Goldman," *Wall Street Journal*, February 11, 2015 http://www.wsj.com/articles/regulation-is-good-for-goldman-1423700859?KEYWORDS=Regulation+Is+Good+for+Goldman.

[15] Registered investment advisors generally have a fiduciary duty toward their clients but others giving "investment advice" in other contexts, including many persons that will be subject to the proposed rule, do not currently have a fiduciary duty.

[16] "Safeguarding Our Savings: Protecting New Yorkers Through the Fiduciary Standard," Office of the Comptroller, City of New York, March 2015 ; http://comptroller.nyc.gov/wp-content/uploads/documents/Safeguarding_Our_Savings.pdf; "Comptroller Stringer Urges New State Disclosure Law to Protect Consumers," march 25, 2015 https://comptroller.nyc.gov/newsroom/comptroller-stringer-urges-new-state-disclosure-law-to-protect-consumers/.

they are dealing with and make it clear that non-fiduciaries are not obligated to look out for the best interest of the investor. Even non-fiduciaries, however, are subject to FINRA's suitability requirements.

Economic Analysis

The proposed rule will affect a tremendous number of securities professionals. Over 11,000 investment advisers are registered with the SEC.[17] In addition, there are more than 275,000 state-registered investment adviser representatives and more than 15,000 state-registered investment advisers. The Commission and FINRA oversee approximately 5,100 broker-dealers. Registered representatives number about 638,000.[18]

The Department's economic analysis contains three very serious errors of gross magnitude. Any of these three errors is likely to make the proposed rules' costs exceed their benefits. Considered together, the costs certainly exceed the benefits.

First, as the Department acknowledges, a transfer from industry to investors is not a social welfare gain – it is simply a transfer of resources. Ergo, in a cost benefit analysis it should not count as a social welfare gain when balanced against the costs. Yet that is precisely what the Department does.

Second, the Department engages is the serious fallacy of thinking that the securities industry can incur a large reduction in revenue and yet maintain the same level of services to its clientele. This is simply not going to happen. The revenue to pay the employees providing the retirement account and investment advice services must be generated or the firms will not be able to profitably provide the services. If a business cannot profitable provide a service, then it will not do so. Ergo, one of two things will happen. Other types of fees will be charged to investors or transactions will not occur. To the extent that new, substitute fees of a different nature but permissible under the new rules are charged, some and perhaps all of the alleged benefits of the rules will evaporate. The higher compliance costs, however, will remain. And there is every reason to believe that they have been grossly underestimated.[19] If instead of alternative fees being imposed, the transactions simply do not occur then that means that a great many retirement plans will often not be established, savings will decline and the retirement income of the American public will be diminished. This does constitute a social welfare loss.

Third, as discussed above, the overwhelming majority of the economic research relied up by the Department[20] and by the Council of Economic Advisors in its report[21] predates the application of

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[17] "Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," Staff of the U.S. Securities and Exchange Commission, January 2011, p. iii https://www.sec.gov/news/studies/2011/913studyfinal.pdf

[18] About FINRA http://www.finra.org/about

[19] See U.S. Chamber of Commerce Comment Letter of May 20, 2015 for a long list of items either underestimated or not taken into account. http://www.dol.gov/ebsa/pdf/1210-AB32-2-00116.pdf.

[20] See list of studies at "Fiduciary Investment Advice, Regulatory Impact Analysis," April 14, 2015 http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[21] "The Effects of Conflicted Investment Advice on Retirement Savings," February 2015, pp. 95-96 https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

Rule 2111 and is, therefore, largely irrelevant. The CEA's "finding" that "conflicted advice leads to losses totaling about $17 billion every year for IRA investors" is equally invalid.[22] Although Rule 2111 is mentioned in the legal discussion in the proposed rule and in the discussion in the Regulatory Impact Analysis incorporated by reference, Rule 2111 is entirely disregarded in the quantitative economic analysis in the proposed rules.

The proposed rules are likely to have an adverse impact on small businesses and on low and moderate income individuals The substantial risks and costs of being a fiduciary will make it much less likely that securities professionals will choose to provide services to low and moderate income individuals and small businesses. The regulatory and litigation risk of assuming the role of a fiduciary and the difficulty in being adequately compensated for both this risk and the cost of providing the services will make it unattractive to service small accounts. Thus, the rule will harm precisely the people it purports to help.

The proposed rules are likely to have an adverse impact on small broker-dealers and other independent securities professionals. This is because the cost of compliance with regulations does not vary linearly with size but instead constitutes a much higher share of small firm gross revenues and has, therefore, a disproportionate adverse impact on small firm profitability. The cost of initial and continuing compliance will disproportionately harm small firms, serve as an additional barrier to entry, impede competition from small, disruptive rivals and foster further concentration in the financial services industry.

The proposed rule should be withdrawn.

Sincerely,

David R. Burton
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[22] Ibid.