July 21, 2015

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

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

Dear Secretary Perez:

The American Association for Justice (AAJ), formerly the Association of Trial Lawyers of America (ATLA), hereby submits the organization's response to the Department of Labor's (the Department) request for comment on the proposed fiduciary regulations.[1]

AAJ, with members in the United States, Canada and abroad, is the world's largest trial bar. It was established in 1946 to safeguard victims' rights and strengthen the civil justice system. In this capacity, we comment in order to ensure access to the courts and to better protect investors from abuses that have become commonplace in the financial services market. AAJ recognizes and commends the important step the Department is taking by expanding the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA).

While the more restrictive five-part test was appropriate forty years ago, it is entirely inappropriate now. Transitions in the market have created loopholes allowing financial professionals to represent that they are providing trusted advice without requiring them to fulfill the legal obligations that come with relationships of trust. As a result, financial advisers are allowed to offer what any reasonable retirement investor would consider as advice that they can rely on without being subject to necessary protections against conflicts.

I. The Fiduciary Rule is Necessary to Protect Investors

It is clear that these rules must be updated to reflect the current market. When the fiduciary rule under ERISA was first promulgated in 1975, the retirement landscape looked very

[1] *See* 80 FR 21928; 80 FR 21960.

different. At that time, defined-benefit (traditional pension) plans predominated, Individual Retirement Accounts (IRAs) had just been created, and 401(k)s didn't even exist. Since 1975, however, the number of active participants in private-sector defined contribution plans increased from 11.2 million to 75.4 million in 2012, while the number of active participants in private-sector defined benefit plans declined from 27.2 million to 15.7 million during the same time period.[2]

Many of these private-sector investors, however, do not realize that the people they turn to may not owe them a legal obligation to serve their best interests. In fact, many financial professionals who are typically not fiduciaries hold themselves out as trusted advisers and use titles such as "financial adviser" or "financial consultant." Use of these titles is deliberate and intended to give consumers the reasonable belief that they are getting advice designed to serve their best interests and to convince consumers that they are in a relationship of trust. According to a Rand Corporation survey of investors' beliefs about different financial service professionals, 59 percent mistakenly believed that "financial advisors or financial consultants" are required by law to serve their client's best interest.[3] The Rand study also indicated that many investors are incapable of telling whether their own adviser is a broker or an investment adviser, let alone whether he or she owes them a fiduciary duty.

When consumers receive financial advice that is not in their best interest, it can cause real harm. Financial professionals who are not required to put their client's interests first are free to steer retirement savers into excessively high cost, low performing investments that drain hard-earned savings while maximizing the professional's profits. Practices like theses can cost retirement savers a lot of money. Working from the various studies, the Department estimates that retirement savers will lose between $210 billion and $430 billion over 10 years, and between $500 billion and $1 trillion over 20 years, as a result of conflicted advice just with regard to mutual fund investments in IRAs. The Department also estimated that a retirement saver who rolls money out of a 401(k) plan and into an IRA based on conflicted advice can expect to lose 12 to 24 percent of the value of his or her savings over 30 years.

Unfortunately, moderate income Americans—those who save for retirement in the smallest amounts—can least afford to have their retirement savings diminished due to conflicted advice and are at the greatest risk. According to the industry's own data, moderate income savers are disproportionately served by advisers who are not required to serve their best interests.[4] Moderate income savers are therefore the most likely to receive and follow harmful advice.

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[2] U.S. Department of Labor. Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables and Graphs (June 2013) http://1.usa.gov/Rp8Bwu.

[3] Angela A. Hung, et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, Rand Corporation, Sponsored by the United States Securities and Exchange Commission, January 2008, http://1.usa.gov/1nePF0L.

[4] Letter from Kent Mason, Partner at Davis and Harman, citing Oliver Wyman's "Assessment of the impact of the Department of Labor's proposed 'fiduciary' definition rule on IRA consumers," April 12, 2011, http://1.usa.gov/1CyB9V2.

Another problem caused by the current loopholes is that advisors could not be held personally liable for any losses to investors caused by their misconduct.[5] These proposed rules help to fix this problem by providing a mechanism to hold firms and advisors accountable. Regrettably, however, the regulatory package fails to address the abusive practice of forced arbitration and that failure makes the package incomplete. Forced arbitration is growing in disfavor not only among the public but in other agencies as well. Because the current package allows forced arbitration and its abuses to continue, consumers will remain at a significant disadvantage. This unequal power dynamic between investors and advisors ought to be addressed.

II. The Fiduciary Rule Will Not Result in a Litigation Explosion

Opponents of the proposed rules argue that increased responsibilities and obligations will result in a litigation explosion that would drive financial advisors away and harm small businesses. This is inaccurate. The proposed rules clearly state that existing FINRA policy will continue to apply. In addition, both FINRA and U.S. State and Federal Courts already contain numerous, oft-utilized safeguards to ensure minimum standards are met before litigation can commence, and that non-meritorious claims are sufficiently deterred when appropriate.

While imposing a fiduciary duty for additional advisors can impose additional legal obligations, investors will bear the burden of proving that certain rights were violated and that an actual loss occurred as a result. Simply giving bad advice does not meet the standard for a colorable legal claim. Under the current *Iqbal* and *Twombly* standard, cases must meet a heightened pleading standard, or they will be dismissed.[6] When having to plead a case against a fiduciary for a breach of duty claim, these standards will be particularly demanding.

In addition to heightened pleading requirements, threats of sanctions, dismissal and procedural roadblocks all work against plaintiffs attempting to bring a lawsuit and deter non-meritorious claims. For example, under Federal Rules of Civil Procedure Rule 11, sanctions are available to deter uncivil conduct, such as requiring plaintiffs to cover a corporate defendants' fees and costs for filing a frivolous law suit. Similarly, from a practical standpoint, since most cases would be handled by attorneys on a contingency fee basis, attorneys must take into account the financial risk they face if there is no or limited recovery. Because of this risk, attorneys have no incentive to pursue unjustified cases.

Opponents of the proposed rules have also attacked the ban on class action waivers. Such opposition is an attempt to keep the playing field tilted against consumers. Class actions serve a valuable function is promoting the effective administration of justice and they are not freely

[5] 80 F.R. 21933.
[6] *Ashcroft v. Iqbal,* 556 U.S. 662, 129 S.Ct. 1937 (2009); *Bell Atlantic v. Twombly,* 127 S.Ct. 1955 (2007).

granted. For a class action to proceed, a federal court must certify the class after a judge has considered several factors. To be certified under Rule 23 of the Federal Rules of Civil Procedure, plaintiffs must show that the potential class is so numerous that joinder of all the class members is impractical; that there are questions of law or fact common to the class; that the claims or defenses of the class representatives are typical of the claims or defenses of the class; and that the representative parties will fairly and adequately protect the interests of the class. Meeting each of these prerequisites is difficult, and the proposed rules will do nothing to lessen that difficulty.

Claims of a supposed "litigation explosion" surrounding the Department's proposed rules are simply unfounded They have no basis in fact and are simply a pejorative way of diverting attention away from the important goal of the proposed rules package: preventing retirement savers from being deprived of sound investment advice.

III. FINRA Processes and Procedures Must Be Improved

A. Forced FINRA Arbitration Will Leave Consumers Vulnerable

Since 1987 when the Supreme Court ruled in *Shearson v. McMahon* that a brokerage firm could force customers to arbitrate legal disputes, investors have involuntarily been denied access to the civil justice system.[7] Following Shearson, the sole avenue to obtain relief for most investors is through FINRA arbitration. Indeed, this proposal follows FINRA's policy with regard to arbitration of claims and ensures that the vast majority of claims will be heard in the industry-run FINRA arbitration forum. While investors may "win" FINRA arbitrations, they receive significantly less than they deserve. For example, a study analyzing 14,000 FINRA arbitration awards over a ten-year period found that investors with significant claims suing major brokerage firms could expect to recover only 12 percent of the amount claimed.[8] While FINRA has made improvements to its forced arbitration system since its inception, the mandatory nature of the current dispute resolution process undermines a fair and robust forum, leaving consumers at a distinct disadvantage.

B. FINRA Rules Must Protect Consumers

In addition to making FINRA arbitration voluntary, the Department should take a number of steps to improve the processes and procedures of arbitration so that consumers are protected. First, the arbitration application process should be streamlined to be more accessible and work to create a diverse arbiter pool. The current process is a lengthy two-step evaluation requiring a

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[7] *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987).
[8] Edward S. O'Neal, Ph.D. and Daniel R. Solin, Mandatory Arbitration of Securities Disputes — by Edward S. O'Neal, Ph.D. and Daniel R. Solin1 A Statistical Analysis of How Claimants Fare, Securities and Litigation and Consulting Group, June 2007, http://bit.ly/1LtUCgU.

thirty plus page application and signed consent to a background search.[9] Step One can require up to 45 days to complete before successful applicants may proceed to Step Two, which requires another 45 day screening. While we recognize the importance of thorough evaluations and investigations of persons tasked with resolving these disputes, this process should be relaxed in order to attract a wider and better-rounded candidate pool.

FINRA should also strengthen their rules on expungement. There are a growing number of requests from brokers to expunge their records of complaints. This directly undercuts the ability of investors to choose qualified brokers. FINRA should institute more extensive training for a select group of arbitrators regarding the criteria for expungements. Further, the specially-trained arbitrators should be required to issue written reports of their decisions, setting forth in full the facts and rationale upon which their decisions were based. Doing so will create a record that can later be reviewed should a broker commit further wrongdoing and may serve as grounds for revoking his or her FINRA license.

Lastly, FINRA should improve arbitrator disclosures. FINRA does not provide complete disclosures regarding the backgrounds of arbitrators before parties make their selections. Moreover, arbitrator disclosures are not regularly updated which means the information relied upon by consumers to select their panel of arbitrators may not be accurate. There must be improvements to the accuracy and scope of information currently available on FINRA arbitrators to include comprehensive details of each arbitrator's work histories.

C. Banning Class Action Waivers Protects Consumers

We do recognize the Department's departure from FINRA through its proposed prohibition of the use of class action bans and waivers from contracts entered pursuant to the Best Interest Contract Exemption.[10] Investors' ability to join together as a class brings relief to those who suffer identical or similar harms where a singular, individualized action would be cost-prohibitive to pursue. By prohibiting class action bans or "waivers," the Department refuses to allow bad actors in the securities industry the ability to act with impunity. When, as is often the case for small investors, the cost and expense of pursing an individual claim in arbitration far exceeds any possible recovery, a waiver of the right to participate in any collective action effectively immunizes corporations from these smaller claims. The risks are simply too great. We strongly urge the Department to include this prohibition on class action bans and waivers in the final rule.

In conclusion, AAJ recognizes these proposed rules as an important step to protecting the retirement savings for all Americans. Yet, as the Department assesses the responses to these

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[9] FINRA Arbitrator Application, November 2014, *available at* http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p017271.pdf.
[10] *See* 80 FR 21960.

proposed rules, the detrimental impact of forced arbitration clauses cannot be ignored. It would be impossible to make meaningful changes to a market that has allowed for systematic and abusive practices without ensuring accountability. These rules must make certain that consumers are protected, allowing them to litigate their claims against those whose misconduct has cost them financial security when they need it most. AAJ appreciates this opportunity to submit comments in response to the Department's fiduciary rules. If you have any questions or comments, Zoë Oreck, AAJ's Assistant Regulatory Counsel, at (202) 944-2869.

Sincerely,

Larry A. Tawwater
President
American Association for Justice