

# COMMITTEE ON CAPITAL MARKETS REGULATION

September 24, 2015

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

VIA ELECTRONIC MAIL: [e-ORI@dol.gov](mailto:e-ORI@dol.gov)

Re: RIN 1210-AB32, Definition of the Term “Fiduciary”; Conflict of Interest Rule —  
Retirement Investment Advice

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the “**Committee**”) is grateful for the opportunity to comment on the proposed regulation by the Department of Labor (the “**Department**”) under the Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), which would redefine the term “fiduciary” under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code of 1986, as amended (the “**Code**”), and on certain related exemptions (collectively, the “**Proposed Rule**”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-four leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Proposed Rule would for the first time apply certain fiduciary obligations to broker-dealers selling investment products for retirement. It would also expand fiduciary obligations for investment advisers with regards to investments for retirement. The Committee commends the Department for its commitment to seeking to safeguard the interests of retirement investors. However, we believe the Proposed Rule contains a number of issues that must be addressed prior to finalization. In order to ensure that changes to the Department’s proposal do not have unintended consequences, we urge the Department to re-propose its rule to ensure it achieves its stated goal of protecting retirement investors.

This letter sets forth four principal concerns with the Proposed Rule that have been widely recognized by industry regulators, investor representatives, investment firms and professionals, and other industry experts. First, the Proposed Rule’s new definition of “fiduciary”

investment advice will unduly expand ERISA fiduciary liability to include business practices of brokers<sup>1</sup> that do not constitute fiduciary investment advice. Second, the proposed “Best Interest Contract Exemption” is administratively impracticable and in tension with existing regulations applicable to brokers. Third, the rule encourages a compensation structure that will raise costs for many investors and will disproportionately burden lower- and middle-income investors. Fourth, the Department’s Regulatory Impact Analysis lacks quantitative support and underestimates significant costs.

The Proposed Rule would make it more difficult for broker-dealers and investment advisers to provide innovative, diverse, and affordable retirement investment services and products to investors. Access to investment advice would be more limited and more expensive for millions of Americans planning for retirement. We therefore recommend that the Department re-propose the rule after a deliberate review of the roughly 3,000 comments that the Proposed Rule and related exemptions have elicited.

### *The Proposed Definition of “Fiduciary” Investment Advice is Too Broad*

Under the Proposed Rule’s new definition of fiduciary investment advice, any individual who receives “a fee or other compensation, direct or indirect” for providing advice “individualized to, or specifically directed to, the recipient for consideration in making investment or management decision with respect to securities or other property of [an employee benefit plan] or IRA” would be subject to ERISA fiduciary liability.<sup>2</sup> ERISA fiduciary obligations are unique in that they are founded in trust law and require a fiduciary to “discharge his duties with respect to a plan *solely* in the interest of the participants... and for the *exclusive* purpose of” benefiting the participants and defraying administrative expenses [emphasis added].<sup>3</sup> ERISA fiduciaries may be held *personally* liable for losses caused by their breach of duties.<sup>4</sup>

As proposed, the definition of fiduciary would include ordinary course communications such as marketing materials and research reports,<sup>5</sup> which neither professionals nor investors should reasonably consider to be “fiduciary” investment advice.<sup>6</sup> Under the rule, these communications would trigger the demanding ERISA fiduciary obligations, resulting in increased costs and reduced availability of basic investment services and products.<sup>7</sup>

---

<sup>1</sup> Throughout this letter, we primarily refer to “brokers” and “broker-dealers” in identifying those financial professionals potentially impacted by the Department’s Proposed Rule. We note that our observations of the Proposed Rule’s implications also apply to other sellers of financial products, including annuities.

<sup>2</sup> Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,929 (April 20, 2015).

<sup>3</sup> 80 Fed. Reg. 21,932-33; 29 U.S. Code §1104.

<sup>4</sup> 29 U.S. Code §1104.

<sup>5</sup> See, e.g., American Retirement Association, Re: Definition of Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice RIN 1210-AB32, July 20, 2015, p. 13-14 (*hereinafter*, “ARA Letter”); SIFMA Re: RIN 1210-AB32 (July 20, 2015), Executive Summary (“ES”) at 2 (*hereinafter*, “SIFMA Letter”); Vanguard Re: Proposed Conflict of Interest Rule RIN 1210-AB32 (July 21, 2015) at 2-4 (*hereinafter*, “Vanguard Letter”).

<sup>6</sup> See, e.g., SIFMA Letter at ES 2, 8-14; ARA Letter p. 13-15.

<sup>7</sup> See also Letter from Primerica, Inc., Karen L. Sukin, EVP and Deputy General Counsel, Primerica, Inc., to Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Department of Labor at 10 (July 21, 2015) (on file with author) (*hereinafter* “Primerica Letter”); see also USAA, Re: Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice (RIN 1210-AB32); Proposed Best Interest Contract (BIC) Exemption (ZRIN 1210-ZA25) and Proposed Amendments to Prohibited Transaction Exemption (PTE) 84-24 and 77-4, July 21, 2015, p. 4-6; Investment Company Institute, Re: RIN 1210-AB32 Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, July 21, 2015, p. 4, 5-8, 16 (*hereinafter*, “Investment Company Letter”); Financial Industry Regulatory Authority, Re: Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32, July 17, 2015, p. 12-13; Financial Services Institute Letter at 3-4, Re: Definition of the Term “Fiduciary” (RIN 1210-AB32); Best Interest Contract Exemption (ZRIN 1210-ZA25), July 21, 2015, p. 3-4 (*hereinafter*, “Financial Services Institute Letter”); The Spark Institute, Inc., Re: Definition of the Term “Fiduciary”;

The broad definition of fiduciary investment advice is circumscribed only by narrow and ineffective exceptions. For example, the Proposed Rule contains a narrow “investment education” exception, which is designed to allow for the distribution of “investment education information and materials” without activating fiduciary obligations.<sup>8</sup> However, the exception is unavailable if the materials include recommendations regarding “specific investment products or specific plan or IRA alternatives, or recommendations on... value...”<sup>9</sup> It is widely recognized among commenters that this provision and its extensive limitations on references to “specific” plans or products fails to insulate the educational information that is actually *useful* to investors in making their own investment decisions from the statutory fiduciary regime.<sup>10</sup> If adopted, the rule’s concomitant risks and compliance costs would likely discourage firms from furnishing valuable educational materials to investors.<sup>11</sup>

The proposed “counterparty carve-out” is similarly flawed.<sup>12</sup> The carve-out is intended to remove sales pitches and marketing communications made to an “expert plan investor” from any fiduciary obligations,<sup>13</sup> but its conditions render it inapplicable to many sales communications to retail investors.<sup>14</sup> To invoke the exception, the adviser must either: (a) receive written confirmation from the plan investor that at least 100 participants are covered by the plan; or (b) “know or reasonably believe” that the plan investor is responsible for managing at least \$100 million in employee benefit plan assets.<sup>15</sup> The Department therefore subjects sales pitches and marketing communications to retail investors to the fiduciary standard. This is because “retail investors, including small plans, IRA owners, and plan participants” are, in the Department’s view, unqualified to make the commonsense determination that they are listening to a sales pitch in which the counterparty likely has a financial stake.<sup>16</sup>

We join the numerous other commenters who have observed that this putative attempt to protect retail investors paints with far too broad a stroke, instead putting smaller investors at a disadvantage.<sup>17</sup> As one commenter observes, the Department should be able to identify a

---

Conflict of Interest Rule – Retirement Investment Advice (RIN 1210-AB32) Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25), July 21, 2015, p. 3-4 (*hereinafter*, “Spark Letter”).

<sup>8</sup> 80 Fed. Reg. 21,944.

<sup>9</sup> 80 Fed. Reg. 21,958.

<sup>10</sup> See generally SIFMA Letter at ES 2-3; Vanguard Letter at 9-10; U.S. Chamber of Commerce, *Locked Out of Retirement: The Threat to Small Business Retirement Savings*, p. 5 (introduced into the record in U.S. Chamber of Commerce, Re: Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice. Document No. 2015-08831, RIN 1210-AB32, June 24, 2015), United States Senate Committee on Finance, Re: Comments on Proposed Regulations on Definition of the Term “Fiduciary” – RIN 1210-AB32, August 7, 2015, p. 3, ARA Letter, p. 13-15

<sup>11</sup> See SIFMA Letter at ES 3-4. *See also* Primerica Letter at 14; *see also* Vanguard Letter at 10; *see also* Fidelity Letter at 7-8; *see also* Wells Fargo Letter at 11.

<sup>12</sup> *See* NFIB, Re: Definition of Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, and associated proposed exemptions RIN 1210-AB32, July 21, 2015, p. 3-4 (*hereinafter*, “NFIB Letter”); *see* Capital Group, Re: RIN 1210-AB32; Conflicts of Interest Rule ZRIN 1210-ZA25; Proposed Class Exemption, July 20, 2015, p. 15-16 (*hereinafter*, “Capital Group Letter”); *see* Keehan Letter at 11, 17-19. *See also* Fidelity Letter at A-1, B-3, B-4; *see also* Spark Letter at 4; Primerica Letter at 11-13; *see also* Wells Fargo, Re: Comments on Proposed Conflict of Interest Rule and Related Proposals [RIN: 1210-AB32 and ZRIN: 1210-ZA25] (July 21, 2015) p. 5-6 (*hereinafter* “Wells Fargo Comments and Proposals”); *see also* Vanguard Letter at 8; *see also* Financial Services Roundtable, Re: Revised Definition of Investment Advice and Related Exemptions (July 21, 2015), p. 43-44 (*hereinafter*, “Financial Services Letter”).

<sup>13</sup> 80 Fed. Reg. 21,941.

<sup>14</sup> *See also* Fidelity Letter at B-2.

<sup>15</sup> 80 Fed. Reg. 21,941.

<sup>16</sup> *See*, e.g., Fidelity Investments Re: Definition of the Term Fiduciary: Conflict of Interest Rule (RIN 1210-AB32); Proposed Best Interest Contract Exemption and Principal Transactions in Debt Securities Exemption (ZRIN: 1210-ZA25) at B-3.

<sup>17</sup> *See*, e.g., Vanguard Letter at 8-9; SIFMA Letter at ES 3, 8-9, 25-26, 40; American Retirement Association, Re: Definition of Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice RIN 1210-AB32, July 20, 2015, p. 18. *See also* Financial Services Letter at 3-4; *see also* Investment Company Letter at 17-18; Financial Services Institute Letter at 2; *see also* Spark Letter at 4.

disclosure threshold that is adequate to signal that a sales communication is underway: “[t]here is simply no legal difference when one is selling in the retail context versus a large plan context.”<sup>18</sup> Instead of protecting small plans, compelling such plans to incur the costs of a fiduciary adviser may simply discourage employers from offering retirement benefits at all.<sup>19</sup> We therefore recommend that this carve-out be expanded to include retail investors.

The scope of the counterparty carve-out is also unjustifiably narrow in its apparent failure to cover sales of *services*, such as brokerage services and futures execution services.<sup>20</sup> The carve-out expressly applies to advice provided by a counterparty to a plan “with respect to an arm’s length sale, purchase loan or bilateral contract between the plan and the counterparty, or with respect to a proposal to enter into such a sale, purchase loan or bilateral contract...”<sup>21</sup> There is no substantive distinction between the sale of services and products that justifies this omission.

### *The Best Interest Contract Exemption is Conceptually and Technically Flawed*

The Proposed Rule’s Best Interest Contract Exemption (“**BICE**”) is intended to accommodate certain traditional compensation arrangements for investment advice to retail retirement investors.<sup>22</sup> The BICE would allow new statutory “fiduciaries” (e.g. brokers) to continue to receive common forms of compensation that could otherwise violate the “prohibited transaction” provisions of ERISA and the Code against “self-dealing and receiving compensation from third parties in connection with transactions involving the [employee benefit] plans and IRAs.”<sup>23</sup> “Prohibited transactions” trigger excise taxes under the Code.<sup>24</sup>

In order to invoke the BICE, brokers, investment advisers and their firms must enter into contracts with their clients that explicitly acknowledge their ERISA fiduciary status. They must also make certain warranties as to their policies, procedures, and compliance with applicable state and federal laws.<sup>25</sup> Brokers, advisers and their firms must also provide certain disclosures relating to conflicts of interest and costs of advice.<sup>26</sup> In addition, firms are required to give the Department advance notice that they will use the exemption and keep records of certain data for the Department’s discretionary review.<sup>27</sup> These contractual, record-keeping, and disclosure obligations are intended to formalize advisers’ and brokers’ utmost commitment to providing advice that is in the clients’ best interest.

We agree in principle with the Department’s adoption of a “best interest” standard for broker-dealers.<sup>28</sup> However, there are both conceptual and technical deficiencies to the approach adopted in the Proposed Rule.<sup>29</sup>

---

<sup>18</sup> SIFMA Letter at ES 3.

<sup>19</sup> Vanguard Letter at 8-9. See also Financial Services Letter at 3-4.

<sup>20</sup> See, e.g., SIFMA Letter at 39.

<sup>21</sup> 80 Fed. Reg. 21, 957.

<sup>22</sup> 80 Fed. Reg. 21,929; Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960 (April 20, 2015) (*hereinafter*, “BIC Exemption”).

<sup>23</sup> 80 Fed. Reg. 21,960.

<sup>24</sup> 26 U.S.C. § 4975; See also, 80 Fed. Reg. 21,933.

<sup>25</sup> 80 Fed. Reg. 21,948.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> Notable commenters in support of such a standard include FINRA, see, e.g., Re: Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32, July 17, 2015, p. 2 (*hereinafter*, FINRA Letter), SIFMA, see, e.g., “Proposed Best Interests of the Customer Standard for Broker-Dealers” (June 3, 2015), available at: <http://www.sifma.org/issues/item.aspx?id=8589954937>, Wells Fargo Comments and Proposals at 1-3.

As drafted, the BICE suffers from a serious conceptual flaw. The Department's decision to subject retirement products to a distinct "best interest" standard creates practical confusion and tension with the regulatory system currently in place for broker-dealers. Confusion would result because investors generally make investment decisions in terms of their entire investment portfolios, not separate retirement and non-retirement investments.<sup>30</sup> More importantly, broker-dealers are subject to an existing regulatory framework, defined by the federal securities laws and FINRA rules.<sup>31</sup>

This framework includes standards of conduct governing broker-dealer relationships with customers.<sup>32</sup> Notably, FINRA's "suitability rule" has been repeatedly interpreted to legally require that "a broker's recommendation must be consistent with his customers' best interests."<sup>33</sup> As FINRA itself explains, "the suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests. Examples of instances where FINRA and the SEC have found brokers in violation of the suitability rule by placing their interests ahead of customers' interests include... a broker whose motivation for recommending one product over another was to receive larger commissions."<sup>34</sup>

The Department's parallel regime is not only arguably unnecessary in light of this existing framework, but it potentially *undermines* customers' protection under FINRA's structure. Indeed, FINRA itself notes that the Proposed Rule "does not meet some of the minimum criteria for [a best interest] standard," "does not incorporate existing regulation and introduces new concepts that are fraught with ambiguity" and "in some respects the [Proposed Rule] even conflicts with existing FINRA rules and securities market trading practices."<sup>35</sup> We

---

<sup>29</sup> See Primerica Letter at 21-22; see also Wells Fargo Letter at 33-34; see also Financial Services Letter at 5, 13-14; see also Investment Company Institute Letter at 10-14; see also FINRA Letter at 4-6.

<sup>30</sup> FINRA Letter p. 3. See also Letter from Timothy E. Keehan, Senior Counsel, Center for Securities Trusts & Investments to Joe Canary, Director, Office of Regulations and Interpretations at the U.S. Department of Labor, p. 27 (July 21, 2015) (on file with author) (*hereinafter* "Keehan Letter"); see also Fidelity Letter at 3, 17, C-13.

<sup>31</sup> FINRA, see, e.g., Re: Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32, July 17, 2015, p. 3. Financial professionals are also subject to pertinent regulations pursuant to state insurance laws and IRS regulations. Potential conflicts with these regulatory frameworks must also be evaluated and reconciled by the Department. For instance, the National Association of Insurance Commissioners noted that, "[f]rom a consumer protection standpoint, it is important that the approaches we as regulators take within the regulatory framework are consistent and compatible as much as possible." Letter from National Association of Insurance Commissioners to Secretary Perez, July 21 2015.

<sup>32</sup> See, e.g., FINRA Letter p. 3: "Among the many requirements imposed are the principles that broker-dealers deal fairly with customers, adhere to just and equitable principles of trade, and ensure that recommendations are suitable for customers."

<sup>33</sup> <http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq>. See Footnote 69 of FINRA's FAQ: "Raghavan Sathianathan, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at \*21 (Nov. 8, 2006) [aff'd, 304 F. App'x 883 (D.C. Cir. 2008)]; see also Scott Epstein, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at \*40 n.24 (Jan. 30, 2009) ("In interpreting the suitability rule, we have stated that a [broker's] 'recommendations must be consistent with his customer's best interests.'"), aff'd, 416 F. App'x 142 (3d Cir. 2010)]; Dane S. Faber, 57 S.E.C. 297, 310, 2004 SEC LEXIS 277, at \*23-24 (2004) (stating that a "broker's recommendations must be consistent with his customer's best interests" and are "not suitable merely because the customer acquiesces in [them]"); Wendell D. Belden, 56 S.E.C. 496, 503, 2003 SEC LEXIS 1154, at \*10-11 (2003) ("As we have frequently pointed out, a broker's recommendations must be consistent with his customer's best interests."); Daniel R. Howard, 55 S.E.C. 1096, 1100, 2002 SEC LEXIS 1909, at \*5-6 (2002) (same), aff'd, 77 F. App'x 2 (1st Cir. 2003); Powell & McGowan, Inc., 41 S.E.C. 933, 935, 1964 SEC LEXIS 497, at \*3-4 (1964) (same); Dep't of Enforcement v. Evans, No. 20006005977901, 2011 FINRA Discip. LEXIS 36, at \*22 (NAC Oct. 3, 2011) (same); Dep't of Enforcement v. Cody, No. 2005003188901, 2010 FINRA Discip. LEXIS 8, at \*19 (NAC May 10, 2010) (same), aff'd, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862 (May 27, 2011); Dep't of Enforcement v. Bendtsen, No. C01020025, 2004 NASD Discip. LEXIS 13, at \*12 (NAC Aug. 9, 2004) ("[A] broker's recommendations must serve his client's best interests[.]" and the "test for whether a broker's recommendation[s] are] suitable is not whether the client acquiesced in them, but whether the broker's recommendations were consistent with the client's financial situation and needs."); IA/BD Study, *supra* note [68], at 59 ("[A] central aspect of a broker-dealer's duty of fair dealing is the suitability obligation, which generally requires a broker-dealer to make recommendations that are consistent with the best interests of his customer.")"

<sup>34</sup> *Id.*

<sup>35</sup> FINRA Letter at 4.

therefore recommend that the Department take a close look at FINRA's specific recommendations to address the BICE's challenges, including its potential to create regulatory conflict.<sup>36</sup>

The extraordinary administrative burdens placed on those who would invoke the BICE also render it practically unworkable.<sup>37</sup> The onerous written contract requirement may discourage clients from seeking out investment advice,<sup>38</sup> and the additional paperwork demands would be excessive, costly, and likely confusing to investors.<sup>39</sup> In addition, the language of the BICE's substantive requirements requires clarification.<sup>40</sup> For example, brokers, advisers and their firms must agree to provide investment advice that is in the customer's best interest "*without regard to the financial or other interests of the [a]dviser, [f]inancial [i]nstitution... or other party [emphasis added].*"<sup>41</sup> However, as others have observed,<sup>42</sup> firms provide investment advice in order to turn a profit, so they could never meet a standard that entirely prohibited them from considering their financial interests. The penalties and remedies for BICE violations are also unclear.<sup>43</sup> Compliance by firms will be difficult and expensive unless these requirements are simplified and clarified.<sup>44</sup>

In addition, the BICE applies only to a list of statutorily-enumerated "assets," and expressly excludes "any equity security that is a security future or a put, call, straddle, or any other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."<sup>45</sup> Compensation received in connection with the "purchase, sale or holding" of such equity securities is therefore ineligible for the BICE.<sup>46</sup> Excluding these securities is likely to have a negative impact on liquidity and flow of funds in these markets.

We concur with the regulators and other industry experts who have called for the establishment of a uniform "best interest" standard for broker-dealers and investment advisers giving individualized advice to retail investors.<sup>47</sup> Federal securities laws and the views of expert regulators of broker-dealers should form the basis of this standard.

---

<sup>36</sup> See generally, FINRA Letter.

<sup>37</sup> See SIFMA Letter at ES 3; See also Wells Fargo Comments and Proposals, Appendix A, p. 1-3; see also Fidelity Investments, Re: Definition of the Term Fiduciary: Conflict of Interest Rule (RIN 1210-AB32); see also Proposed Best Interest Contract Exemption and Principal Transactions in Debt Securities Exemption (ZRIN 1210-ZA25), July 21, 2015, p. 2 (*hereinafter*, "Fidelity Letter"); see also Primerica Letter at p. 16-38; see also Wells Fargo Letter at 14-18; See also Capital Group Letter at 9; see also Keehan Letter at 16; see also NFIB Letter at 3; see also Fidelity Investments Letter at 6-7, A-7-8; see also Financial Services Roundtable Letter at 51-52; see also Investment Company Letter at 3-5 (summary), 6-*infra*.

<sup>38</sup> Martha G. King, Vanguard, Re: Proposed Best Interest Contract Exemption (July 21, 2015) at 3. See also NFIB Letter at 5.

<sup>39</sup> Id. See also Fidelity Investments Letter at C-5.

<sup>40</sup> See, e.g., FINRA Letter p. 6-8. See also Keehan Letter at 8.

<sup>41</sup> 80 Fed. Reg. 21,987.

<sup>42</sup> See, e.g., FINRA Letter p. 6-7.

<sup>43</sup> FINRA Letter p. 19-21.

<sup>44</sup> See generally, id. See also Vanguard Letter at 4-5; see also Keehan Letter at 2; see also Financial Services Letter at 11-13; see also FINRA Letter at 8, 12-14, 18; see also Small Business Investor Alliance, Re: Proposed Best Interest Contract Exemption (ZRIN: 1210-ZA25), July 21, 2015, p. 3 (*hereinafter*, "SBIA Letter"); see also Financial Services Institute Letter at 3; see also Spark Letter at 5; see also Investment Company Letter at 29-30.

<sup>45</sup> 21, 967-21,968.

<sup>46</sup> See 21,966-21,967.

<sup>47</sup> See "Proposed Best Interests of the Customer Standard for Broker-Dealers" (June 3, 2015), available at:

<http://www.sifma.org/issues/item.aspx?id=8589954937>, FINRA Letter p. 3, SEC Commissioner Daniel Gallagher Re: Fiduciary Proposal (July 21, 2015), p. 2. See also FINRA Letter at 8-11.

## *Changes to Compensation Structures Will Have Unintended Consequences*

The Proposed Rule's statutory regime evinces a strong bias towards fee-based compensation schemes that depend on assets under management instead of commission-based schemes that can depend on the frequency of a customer's transactions.<sup>48</sup> When an investor is charged commissions, he generally pays every time the adviser buys or sells securities for his account. Under a fee-based system, an investor is typically charged a fixed percentage of the assets she has invested on an annual basis. Commission-based fee models (ubiquitous among brokers) are effectively prohibited under the new fiduciary requirements unless an exemption applies. As a result, firms may choose to stop providing retirement investment advice or restructure their compensation to a fee-based system based on assets under management.<sup>49</sup>

For some financial products, such as annuities, a fee-based system is neither practical nor workable. These products are subject to different charges that encompass more than services but take into account the value of various guarantees. It would be difficult, and would likely cost consumers more, to purchase lifetime income products on a recurring fee-basis.

This result will increase investor costs.<sup>50</sup> Experts project that costs currently associated with some commission-based accounts would increase significantly when switched into a fee-based account.<sup>51</sup> In particular, "buy-and-hold" customers are likely to pay more when charged an annual percentage of assets under management.<sup>52</sup> Firms that retain commission-based structures would also incur extensive compliance costs. Even those for whom the Proposed Rule would be inapplicable under an exception or exemption will incur significant expenses to produce the extensive required paperwork.<sup>53</sup> These costs will be passed onto investors.<sup>54</sup>

Lower- and middle-income investors are especially vulnerable to the harms of this paradigm shift in compensation.<sup>55</sup> Firms will be less likely to offer tailored advice for smaller accounts, because the new costs and liabilities associated with such advice will be disproportionate relative to the profitability of these accounts.<sup>56</sup> Lower income investors will be especially hard hit--98% of IRA investors with under \$25,000 are in brokerage relationships.<sup>57</sup>

Even the Department apparently comprehends the ramifications that we, along with many others, anticipate from its proposed uprooting of established fee conventions. In its published notice of proposed rulemaking, the Department acknowledges that "[a]ccording to [certain] commenters, the disruption of such current fee arrangements could result in a reduced level of

---

<sup>48</sup> See, e.g., SEC Commissioner Daniel Gallagher Re: Fiduciary Proposal (July 21, 2015), p. 1. *See also* Wells Fargo Letter at 20-21.

<sup>49</sup> See Vanguard Letter at 9. *See generally* Financial Services Letter at 14-18. *See also* Capital Group Letter at 10.

<sup>50</sup> See, e.g., SIFMA Letter at ES 3. *See also* Primerica Letter at 19; *see also* Capital Group Letter at 10; *see also* NFIB at 4.

<sup>51</sup> SIFMA Letter at ES 4-5. *See also* Wells Fargo Letter at 21.

<sup>52</sup> FINRA Letter p. 6. *See also* Wells Fargo Letter at 10; *see also* Investment Company Letter at 28-29.

<sup>53</sup> See SIFMA Letter at ES 3; *see also* Primerica Letter at 19.

<sup>54</sup> See, e.g., NFIB Letter. *See also* Fidelity Letter at 7. *See also* Primerica Letter at 19; *see also* Financial Services Letter at 10-11.

<sup>55</sup> See, e.g., SEC Commissioner Daniel Gallagher Re: Fiduciary Proposal (July 21, 2015), p. 1. *See also* NFIB Letter at 1; *see also* Primerica Letter at Appendix 4, p. 9, 11-12, 22; *see also* Capital Group Letter at 10; *see also* Financial Services Letter at 10-11.

<sup>56</sup> See SIFMA Letter at ES 3; See FINRA, *see, e.g.,* Re: Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32, July 17, 2015, p.

<sup>57</sup> See Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers (Oliver Wyman) (April 2011) at 2; SIFMA Letter at ES 4. *See, e.g.,* Primerica Letter at Appendix 4, p. 11-12, 22; *see, e.g.,* Capital Group Letter at 11.

assistance to investors, higher up-front fees, and less investment advice, particularly to investors with small accounts.”<sup>58</sup>

### *The Department’s Regulatory Impact Analysis is Quantitatively Unsound*

The Department’s Regulatory Impact Analysis (“**RIA**”) estimates that the proposal would deliver between \$40-\$44 billion in gains to IRA investors over 10 years, while generating only \$2.4 to \$5.7 billion in compliance costs during that amount of time.<sup>59</sup> We reiterate the concerns raised by other commenters<sup>60</sup> regarding the accuracy of this analysis. The RIA lacks data in support of the proposition that accounts managed by “fiduciaries” perform better than those managed by brokers or other non-fiduciaries.<sup>61</sup> Without such data, it is impossible to quantify the Proposal’s benefits.

SIFMA also notes that the RIA’s cost estimates are based heavily on data that SIFMA provided to the SEC (not to the Department) in connection with an entirely distinct regulatory inquiry.<sup>62</sup> The data was tailored to estimate the compliance costs for a potential SEC fiduciary rule, which the Department itself acknowledges would contain “substantive differences” from the Proposed Rule.<sup>63</sup> Using updated survey data responsive to the Department’s proposal, a report prepared by Deloitte and SIFMA estimates the Proposed Rule’s costs to be nearly double what the RIA projects.<sup>64</sup> The extent of this gap is troubling, particularly for a potential rulemaking of such economic magnitude.

The RIA also fails to consider the impact of financial professionals limiting advice to their clients as a result of the rule. One economic study estimates that “the cost of depriving clients of human advice during a future market correction (just one of the costs not considered by the [Department]) could be as much as \$80 billion or twice the claimed ten-year benefits that [Department] claims for the rule.”<sup>65</sup> The Department itself noted in 2011 that “[f]inancial losses (including foregone earnings) from [financial] mistakes [made by retirement plan participants] likely amounted to more than \$114 billion in 2010... Such mistakes and consequent losses historically can be attributed at least in part to provisions of ERISA that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice.”<sup>66</sup>

Finally, we urge the Department to consider additional costs that the Proposed Rule could generate due to unintended consequences on the capital markets. As discussed above, the BICE

---

<sup>58</sup> 80 Fed. Reg. 21,946.

<sup>59</sup> Fiduciary Investment Advice Regulatory Impact Analysis (April 14, 2015) at 8; 80 Fed. Reg. 21,930.

<sup>60</sup> See Primerica Letter at 31-32; see Compass Lexecon, Comment Letter to the Department of Labor: An Evaluation of the Department’s Impact Analysis of Proposed Rules Relating to Financial Representative Fiduciary Status (July 20, 2015), p. 13-15 (*hereinafter*, “Lexecon Letter”); see Investment Company Letter at 4-32. See also NERA Economic Consulting, Comment on the Department of Labor Proposal and Regulatory Impact Analysis (July 17, 2015), p. 28-38.

<sup>61</sup> SIFMA Letter at ES 4. See also Investment Company Letter at 8-9.

<sup>62</sup> SIFMA Letter at ES 5-6. See also Lexecon Letter at 14-15.

<sup>63</sup> *Id.*, quoting Regulatory Impact Analysis at 161.

<sup>64</sup> Deloitte, “Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor’s Proposed Conflicts of Interest Rule Package” (July 17, 2015) at 24. See also Primerica Letter at 31-32.

<sup>65</sup> Robert Litan & Hal Singer, “Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department of Labor’s Proposed Fiduciary Rule” (July 15, 2015) in Abstract.

<sup>66</sup> 29 CFR Part 2550 (76 FR 66,151-66152).



does not apply to a wide range of equity products, which could result in a negative impact on liquidity and flow of funds for these markets. The narrow principal trades exemption also excludes a host of securities and would likely have a similar effect.

The Committee therefore recommends that the Department conduct a more thorough economic impact study, adequately consult with stakeholders and undertake a careful review of public comments before offering a re-proposal of this rule.

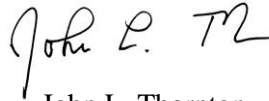
\* \* \* \* \*

Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott ([hscott@law.harvard.edu](mailto:hscott@law.harvard.edu)) or the Executive Director of Research, John Gulliver ([jgulliver@capmksreg.org](mailto:jgulliver@capmksreg.org)) at your convenience.


Respectfully submitted,



R. Glenn Hubbard  
Co-CHAIR



John L. Thornton  
Co-CHAIR



Hal S. Scott  
DIRECTOR