September 24, 2015

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11712
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

RE: Conflict of Interest Rule—Retirement Investment Advice RIN 1210-AB32
Proposed Best Interest Contract Exemption ZRIN: 1210-ZA25; Docket ID EBSA-2014-0016

Dear Secretary Perez:

This comment is submitted by the Center for American Progress, or CAP, a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. As part of its efforts to reduce poverty and ensure a stable middle class, CAP promotes policies to improve the financial well-being of low- and moderate-income households and to ensure a financial system that works for everyone.

CAP appreciates the opportunity to comment once again on the Department of Labor's proposed conflict of interest rule. Overall, CAP commends the Department of Labor's proposed rule and supports the Department's intent to close loopholes, reduce ambiguity, and improve investor confidence in the often-confusing process of receiving retirement advice. Retirement savers largely expect that the advice they receive from financial professionals is already in their best interest, and are often surprised to find that this is not always the case.[1] They deserve legal protections to ensure that this expectation is met under a relationship of trust, particularly given the trillions of dollars in retirement assets at stake.

CAP has already touched upon specific aspects of the rule in a prior comment letter as well as testimony to the Department during the August hearings.[2] Previous comments recommended extending the proposed Best Interest Contract Exemption disclosures to all retirement savings products and restricting the use of mandatory arbitration clauses to ensure that investors' rights are maintained, among other provisions. In addition to these earlier recommendations, this comment letter will address five particular areas of interest based on issues raised since the prior public comment period closed in July.

1. Proposed industry alternatives fail to fully protect investors

Throughout the public comment period and during public hearings, financial industry opponents of the rule have offered alternatives that they claim provide necessary protections for retirement investors. These alternatives, and others, fail to provide the same level of protection to retirement investors as the rule as proposed and should not be adopted.

For example, Fidelity Investments' proposed "new best interest paradigm" explicitly aims to narrow the definition of what qualifies as fiduciary advice under the rule by separating "the terms of engagement of the advisor" from specific investment recommendations, with only the latter subject to a best interest standard. [3] Before establishing a fiduciary relationship, the advisor would negotiate a contract that establishes a given scope of advice, fee structure, and investment options under the former, thereby enabling the advisor to limit investment options to high-fee proprietary products with revenue sharing structures that create conflicts of interest. This structure would also allow advisors to separate an

individual's decision to roll over an employer-provided retirement account from the decision on where those funds should be invested.[4] The end result would be that an advisor could successfully oversee a rollover of low-fee assets from an individual's Thrift Savings Plan to an IRA with dramatically higher fees and still fully comply with the "best interest paradigm." Such an outcome is clearly not in workers' best interest in the vast majority of cases, yet conflicted advice currently leads nearly half of all federal employees to ultimately complete such rollovers after leaving the government.[5]

Similarly, the Financial Services Roundtable's proposed "Simple Investment Management Principles and Expectations Prohibited Transaction Class Exemption," or SIMPLE PTE, [6] would fall short of a true fiduciary standard that requires both prudence and loyalty. The proposed SIMPLE PTE crucially excludes the loyalty requirement and only demands that advisors give prudent advice, contrary to both the Department's proposal and the authority intended for the Securities and Exchange Commission in Section 913 of the Dodd-Frank Act.[7] While a standard of prudence just requires advisors to act with care, skill, and diligence, a standard of loyalty goes further by requiring advisors to act in the sole interest of the investor. Any alternative that fails to institute both of these requirements should not be adopted.

2. A "sophisticated investor" exemption would be inappropriate and unworkable

The idea of defining a "sophisticated investor" is tempting given its precedent under the securities laws.[8] Yet, this concept is generally without merit as long as "sophistication" is merely defined by income or assets. As was noted in *Forbes* during the financial crisis, "Many wealthy people, pension trustees and portfolio managers turned out to be just as incompetent as any amateur. … At its most absurd, our regulatory laws say that Bernard Madoff's victims were sophisticated investors and didn't need protection simply because they were rich enough to lose some of their money."[9] So-called "sophisticated" investors, if they so choose, have ample opportunity to invest outside of the retirement savings system and to assume whichever level of risk they deem is appropriate for them.

However, retirement assets should not be exempt from the Department's rule based on "sophisticated investor" status. A worker near retirement age may have accumulated a high net worth of $1 million or more as a result of many years of savings and investment earnings, and could potentially qualify for such a status without actually demonstrating a high degree of investing knowledge or risk tolerance. Indeed, a number of articles in the popular press suggest the attainment of "401(k) millionaire" status through patient saving and investing.[10] Retirement savings in tax-advantaged plans are crucial to retirees' well-being: a fact recognized by the federal government as made evident by its over $150 billion in tax expenditures for retirement pensions and savings.[11] It is therefore in the interest of both retirees and taxpayers to protect these funds from the greater risks that a "sophisticated investor" potentially faces.

3. A strict definition of "education" is crucial to prevent loopholes

If properly construed, the proposed rule will expand, not hinder, the ability to receive unbiased education. The rule rightly defines education as general in nature, without referral to specific financial products. Attempts to weaken this definition will create a giant loophole for "marketing" services that is not to be confused with actual, impartial advice, as evidenced by the experience of many retirees subject to "free lunch" seminars in which product "education" is largely indistinguishable from sales pitches for inappropriate investment advice.[12]

Yes, some educational efforts will undoubtedly lead to an advice-giving relationship. Financial education is generally more meaningful and effective when tied to actual behavior change, and financial professionals have the ability to help workers overcome the inertia that hinders decision-making.[13] Workers and retirees, however, should be given the distinction between when an advisor is making

specific recommendations with the potential for conflicts of interest and when he or she is merely providing general information in an educational setting. And in the former case, they should have a legal mechanism to seek redress where a trusted relationship is violated through conflicted advice.

4. Transparency and consumer protections will lead to a more competitive market

Providing greater transparency in conflicts, fees, and risks will lead to a more level playing field for firms and professionals already operating under a fiduciary standard, and will require market adjustments for others. Traditional advice-giving models will need to compete with growing technological platforms that offer advice under a fiduciary standard at a fraction of the cost of today's conflicted advice.[14] Fee-based advisors acting under a fiduciary standard will no longer face a disadvantage with others claiming that their advice is "free" while receiving conflicted compensation. These competitive pressures will likely lead to lower fees and greater opportunities for investors, rather than reduced access to advice.

Indeed, directly addressing previously hidden conflicts and risks could expand, rather than hinder, trust in retirement advice. Arguments that the proposed rule would harm small savers are largely inaccurate based on previous regulation of other financial products, such as credit cards and mortgages. Increased regulation in these markets has not generally reduced access for consumers of modest means, provided that the underlying products themselves are safe and appropriate.[15] It has only resulted in limiting access to poor-quality offerings that had the potential to do more harm than good.

5. Disclosures must play a limited, but important, role

Some commenters have argued that the mere disclosure of conflicts is sufficient. However, any effort to replace the department's proposed rule – which implements major protections for investors by prohibiting actions that go against an investor's best interest – with a solely disclosure-based rule is not appropriate. Investors need real protections, complete with legal remedies, when advisors fail to act in the best interest of their clients.

At the same time, clear and conspicuous disclosures specific to an investor's own situation are necessary and important to educate and inform investors, and the disclosure provisions of the rule should be maintained and strengthened. Disclosures proposed in the Best Interest Contract Exemption – a pre-purchase transaction disclosure, annual disclosure, and publicly accessible wage page outlining compensation by investment type – would dramatically improve investors' knowledge of plan fees and potential conflicts of interest, and each deserves to be included in the final rule. CAP has advocated for similar improved disclosures to be used across all defined-contribution and IRA plans.[16]

The transaction disclosure is especially important for those rolling over retirement plans given the potential for dramatically higher fees. Clearly disclosing the estimated amount of fees an investor will pay over 1, 5, and 10 years will help investors hold their advisors accountable. As the average rollover to a traditional IRA in 2013 was $96,660,[17] even small differences in fees can make a dramatic difference in investors' account balances. To assist in comparability between investment options, CAP also advocates adding a "20/20" disclosure that would show the effect of fees on a $20,000 investment over a 20-year period.[18] For this disclosure, adopting a standard hypothetical rate of return for investment options when calculating the compounding effect of fees—for example, an annual return of five percent—would align this disclosure with the SEC's fee example required in mutual fund prospectuses.[19] Explicitly stating that this fee estimate is not a prediction of future performance would further clarify that the disclosure is a "hypothetical illustration of mathematical principles" and not a violation of FINRA's Rule 2210.[20]

The annual disclosure would provide investors a simple, clear way to regularly examine their retirement account's fees. The Department should look to CAP's proposed annual retirement receipt as a model.[21] Specifically, general plan-related administrative fees, even those not tied to a specific asset, should be included in this disclosure. To simplify the disclosure, it could also be modified to only show information on assets currently held at year-end and not details on assets bought and sold during the year. Additionally, providing a publicly-available, machine-readable online compendium of fees and compensation structures will enable potential clients and third parties to easily access the data and compare advisors.

Conclusion

The Department of Labor's proposed rule would protect retirement savers and retirees from costly and often conflicted retirement advice. It would create a legal mechanism to hold financial professionals accountable for violating perceived relationships of trust, and would ensure that the significant public investment made in retirement savings vehicles through tax expenditures ultimately leads to greater financial security for savers, instead of greater compensation to financial firms. It would also provide new and enhanced disclosures under the Best Interest Contract Exemption to give investors additional information about the true costs of the retirement products in which they are investing. Many of the proposed alternatives and exemptions recently suggested by industry would only create new loopholes in a regulation under which major loopholes have persisted for the past four decades, and should be rejected by the Department.

Thank you again for the opportunity to comment on this proposed rule. If you would like to discuss anything in this letter in more detail, please contact Joe Valenti, Director of Consumer Finance, at jvalenti@americanprogress.org, or Alex Rowell, Research Assistant, at arowell@americanprogress.org.

Sincerely,

Center for American Progress

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[1] For example, S. Kathi Brown, "Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants," AARP Research, September 2013, available at http://www.aarp.org/research/topics/economics/info-2014/fiduciary-duty-and-investment-advice---attitudes-of-401-k--and-4.html.

[2] Public comment submission by Center for American Progress to the Department of Labor, "Conflict of Interest Rule—Retirement Investment Advice RIN 1210-AB32; Proposed Best Interest Contract Exemption ZRIN: 1210-ZA25; Docket ID EBSA-2014-0016," July 21, 2015, available at http://www.dol.gov/ebsa/pdf/1210-AB32-2-00639.pdf; Joe Valenti, "The Fiduciary Rule Would Put Savers' and Retirees' Best Interests First" (Washington: Center for American Progress, 2015), available at https://cdn.americanprogress.org/wp-content/uploads/2015/08/12083805/ValentiFiduciaryRule-testimony.pdf.

[3] Public comment submission by Fidelity Investments to the Department of Labor, "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)," July 21, 2015, available at http://www.dol.gov/ebsa/pdf/1210-AB32-2-00658.pdf.

[4] Consumer Federation of America, "Fidelity's 'New Best Interest Paradigm' Does Not Serve the Best Interests of America's Working Families and Retirees," August 31, 2015, available at http://www.consumerfed.org/pdfs/8-31-15%20Fidelity's%20Best%20Interest%20Paradigm%20is%20Unworkable%20for%20Retirement%20Savers_Comments.pdf.

[5] John Hechinger, "Brokers Lure Soldiers Out of Low-Fee Federal Retirement Plan," Bloomberg News, August 12, 2014, available at http://www.bloomberg.com/news/articles/2014-08-12/brokers-lure-soldiers-out-of-low-fee-federal-retirement-plan.

[6] Public comment submission by Financial Services Roundtable to the Department of Labor, "Revised Definition of Investment Advice and Related Exemptions," July 21, 2015, available at http://www.dol.gov/ebsa/pdf/1210-AB32-2-00665.pdf.

[7] Section 913 gives the Securities and Exchange Commission authority to universally extend a duty to act in investors' best interests "without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice." However, the SEC has not acted on this authority to date.

[8] Jason Zweig, "Do You See Yourself as a Sophisticated Investor?" *Wall Street Journal*, July 18, 2014, available at http://blogs.wsj.com/moneybeat/2014/07/18/do-you-see-yourself-as-a-sophisticated-investor/.

[9] John E. Girouard, "The Sophisticated Investor Farce," *Forbes*, March 24, 2009, available at http://www.forbes.com/2009/03/24/accredited-investor-sec-personal-finance-financial-advisor-network-net-worth.html.

[10] Lou Carlozo, "Millennials: How to Become a 401(k) Millionaire," *U.S. News and World Report*, March 18, 2015, available at http://money.usnews.com/money/personal-finance/mutual-funds/articles/2015/03/18/millennials-how-to-become-a-401-k-millionaire; Chuck Saletta, "Here's How to be a 401k Millionaire," The Motley Fool, September 27, 2014, available at http://www.fool.com/retirement/401k/2014/09/27/heres-how-to-become-a-401k-millionaire.aspx.

[11] U.S. Office of Management and Budget, "Analytical Perspectives, Budget of the United States Government, Fiscal Year 2016," available at https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/ap_14_expenditures.pdf.

[12] Milt Freudenheim, "Bad Investment Advice Can Turn a Free Meal Costly," *New York Times*, March 3, 2010, available at http://www.nytimes.com/2010/03/04/business/retirementspecial/04LUNCH.html.

[13] As an example of inertia preventing some savers from executing financial decisions they had intended to make: Robert L. Clark and Madeline B. D'Ambrosio, "Ignorance is Not Bliss: The Importance of Financial Education," TIAA-CREF Institute *Research Dialogue*, Issue No. 78 (December, 2003), available at https://www.tiaa-cref.org/public/pdf/institute/research/dialogue/78.pdf

[14] Rebalance IRA is one example of a new platform offering lower-cost advice under a fiduciary standard, reducing fees for former brokerage clients an average of 68 percent. Rebalance IRA Managing Director Scott Puritz, "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees," Testimony before the Senate Health, Education, Labor and Pensions Committee, Subcommittee on Employment and Workplace Safety, July 21, 2015, available at http://www.help.senate.gov/imo/media/doc/Puritz.pdf.

[15] Joe Valenti, Sarah Edelman, and Julia Gordon, "Lending for Success" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/07/13/117020/lending-for-success/.

[16] Jennifer Erickson and David Madland, "Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them," (Washington: Center for American Progress, 2014), available at https://www.americanprogress.org/issues/economy/report/2014/04/11/87503/fixing-the-drain-on-retirement-savings/; Erickson and Madland, "Retirement Labels and Retirement Receipts Could Save American Investors Billions Each Year," (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/news/2015/07/01/115509/retirement-labels-andretirement-receipts-could-save-american-investors-billions-each-year/.

[17] Craig Copeland, "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database" (Washington: Employee Benefit Research Institute, 2015), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_414.May15.IRAs.pdf.

[18] Erickson and Madland, "Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them."

[19] U.S. Securities and Exchange Commission, "Form N-1A: Instructions," available at https://www.sec.gov/about/forms/formn-1a.pdf (last accessed September 2015).

[20] Financial Industry Regulatory Authority, "2210. Communications with the Public," available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10648 (last accessed September 2015).

[21] Jennifer Erickson and David Madland, "Retirement Labels and Retirement Receipts Could Save American Investors Billions Each Year."