Cetera® FINANCIAL GROUP

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DIRECTOR OF REGULATORY AFFAIRS

July 21, 2015

Employee Benefits Security Administration
Office of Regulations and Interpretations
U.S. Department of Labor
200 Constitution Avenue, NW
Room N-5655
Washington, DC 20210

**Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice RIN 1210-AB32**

**Re: Proposed Best Interest Contract Exemption ZRIN 1210-ZA25**

Ladies and Gentlemen:

On April 20, 2015, the Department of Labor (the "Department") published its notice of proposed rulemaking regarding the definition of the term "fiduciary" of an employee benefit plan and related proposed prohibited transaction exemptions (collectively, the "Proposal"). The Proposal would revise the definition of "fiduciary" for purposes of a plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) as a result of giving investment advice to the plan, its participants, or beneficiaries. The Proposed Regulation would also apply to the definition of a fiduciary of a plan or Individual Retirement Account (IRA) under section 4975 of the Internal Revenue Code of 1986 (the "Code").

The Proposal would greatly expand the number and categories of individuals who are deemed fiduciaries for purposes of ERISA. As discussed in more detail below, we believe that this is unwarranted and will lead to a number of negative and unintended consequences.

Cetera Financial Group (CFG) appreciates the opportunity to comment on this important proposal. We strongly support a uniform fiduciary standard of care that would be applicable to all professionals providing personalized investment advice to retail clients. However, the current Proposal is based on several flawed assumptions and creates a new regulatory regime that is too complex, too cumbersome, and far too costly to manage. The Proposal will make it significantly harder for consumers to receive high-quality, personalized retirement advice. In

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particular, we are concerned that providing services to clients with small account balances will become cost-prohibitive if the proposal is adopted in its current form, thus decreasing investor access to retirement advice.

While CFG cannot support the Proposal as currently written, our goal is to constructively engage with the Department to help ensure that the Proposal does not adversely impact access to retirement advice, and we believe that there are better ways to achieve the goals of investor protection that guide the Department in this effort. Our comments below will address various concerns with the Proposal and in some instances offer alternatives that will serve to further protect investors.

## Cetera Financial Group

Cetera Financial Group (CFG) is the corporate parent of 10 broker-dealers and 4 Registered Investment Advisers (RIAs). These firms have a combined total of more than 9,000 investment professionals, all of whom are registered representatives of one or more of our broker-dealers. The majority of these individuals are also Investment Adviser Representatives (IARs) of one or more RIAs, and provide financial advice and services to more than 1 million customers, with total Assets under Administration in excess of $230 billion.

The vast majority of the CFG client base consists of individual investors. The average client has a substantial portion of their investable assets in qualified retirement accounts such as IRAs or employer-sponsored defined contribution plans such as 401(k) plans. A significant percentage of our clients are self-employed professionals or small business owners. One of their primary goals is funding their retirement, since most of them do not have pensions or other employer-sponsored defined-benefit pension plans. For the most part, our representatives engage with their clients on a holistic basis, and provide them with broad-based financial services covering all aspects of their financial well-being. This often includes tax or estate planning and offering of life insurance or other risk protection products in addition to traditional securities brokerage and asset management services. The average tenure in the securities industry for our representatives is more than 20 years, with client relationships on average longer than 10 years. Our representatives are, in the true sense of the word, trusted advisers who provide advice covering the spectrum of financial issues over the course of their client's lives.

CFG has comments regarding a number of provisions in the Proposal. For ease of reference, we have separated them into sections, set forth below.

### 1. CFG Supports a Uniform Fiduciary Standard

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CFG supports a uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. While broker-dealers and RIAs are already subject to well-developed regulatory and enforcement regimes designed to protect investors, we recognize that the differing standards of care applicable to broker-dealers and RIAs may lead to unnecessary client confusion. We believe that CFG is well-situated to provide input on such a standard because the majority of our representatives are dually-registered as both registered representatives and IARs, and provide both brokerage and investment advisory services to middle-class Americans.

We support a uniform standard of care that is designed to address the same investor protection goals that the Department seeks to address in the Proposal. However, we would go a step further by adopting this standard for advice regarding all investments, not just those made in connection with retirement savings. We strongly encourage the Department to work with the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) on developing this standard jointly and in a unified manner. We believe that this would reflect the Congressional intent expressed in section 913 of the Dodd-Frank Act, which granted the SEC authority to evaluate the effectiveness of existing standards of care and promulgate a uniform standard of care for broker-dealers and investment advisors. Congress expressly stated that any such uniform standard should be reflective of the varied business models and regulatory regimes imposed on each of these entities. We believe that any rulemaking by the Department prior to SEC rulemaking would contradict Congressional intent and lead to inconsistent standards, creating unnecessary compliance burdens for financial advisors, increasing costs for investors, and producing a regulatory regime that is so complicated that it will serve primarily to confuse the very investors it is designed to protect.

The uniform standard of care should define the duty of care that an adviser owes to the client and the duty to identify, disclose, and mitigate conflicts of interest. It should specifically include an obligation to disclose all sources of compensation to the adviser. We submit that the Proposal goes far beyond what is necessary to meet these objectives. Indeed, it identifies certain business models that the Department deems free from conflicts of interest while imposing onerous and unjustified restrictions on others.

**2. A comprehensive regulatory regime covering advice to investors is already in existence.**

The CFG firms are all registered as broker-dealers and as such subject to regulation by the SEC, FINRA, and all 50 states. This regulatory scheme includes a robust and ongoing system of examinations, disclosure, and enforcement by each of these agencies. Several of the CFG broker-dealers are dually-registered as RIAs, and therefore subject to an additional layer of regulation and oversight by the SEC and the 50 states. The federal securities laws have been in existence for 75 years, and are well developed and understood by both investors and financial advisers. FINRA has a comprehensive system for ongoing monitoring of

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broker-dealers that has also been in place for decades. This regulatory framework already covers the relationship between financial advisers and retail customers. We do not see anything in the Proposal to convince us that another layer of regulation will provide additional protection to investors.

**3. The Economic Analysis on which the Proposal is based is questionable**

The Regulatory Impact Analysis for the Proposal includes references to academic research which concludes that retirement investors suffer significant economic harm due to the presence of "conflicted advice" from financial advisers. We believe that the figures set forth in the Regulatory Impact Analysis are based more on anecdotal evidence than rigorous research, and should not be relied upon in connection with the adoption of regulations that will have the far-reaching effects that the Proposal will have. The data cited in the academic studies that serve as the foundation for the Department's analysis is speculative, difficult to measure, and inconsistent with empirical data gathered by independent experts. Much of the data in the Regulatory Impact Analysis was recently called into question by several economists during a hearing regarding the Proposal before the United States House of Representatives Committee on Education and the Workforce. The oral and written testimony of these experts effectively contradicts the findings in the studies on which the Department's Regulatory Impact Analysis relies, including the Department's assertions regarding the harm caused to investors by what the Department characterizes as conflicted advice and the need to take regulatory action in the absence of coordination with the SEC.

In addition to our concerns about the benefits to the investing public, we believe that the Department's analysis vastly underestimates the costs that will be incurred by financial advisers in complying with it. We will offer other specific comments on the Best Interest Contract Exemption (BICE) below, but we believe that the Department has significantly underestimated the costs that will be incurred by financial advisers in complying with its terms. For example, the BICE would require that all clients, including those with long-standing relationships with their advisers, execute a written agreement prior to the provision of any further advice regarding their investments. CFG currently has approximately 1 million IRA accounts. The cost of creating these agreements, delivering them to clients, and gathering the executed copies will be enormous. In addition to the contract requirement, all financial advisers will be required to accumulate vast amounts of data relating to transactions qualified plan accounts, including IRAs, and deliver it to clients at both the point of sale and on an ongoing basis. This will involve development of countless new processes and require thousands of hours of information technology infrastructure and related programming costs. We estimate the cost of this effort for CFG to be in excess of $2 million in the first year alone, and as much as $1 million per year thereafter. CFG is but one of the thousands of firms that will be forced to incur these significant costs. We believe that the Department's estimates of cost to be borne by the financial services industry as a whole is vastly understated.

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We would also point out that all regulation should be premised on a balancing of the benefits to the class of individuals whose interests are sought to be protected versus the cost to the entities that will bear the burden of compliance. In this case, we believe that the benefits to the investing public are greatly outweighed by the cost to the financial services industry, and would urge the Department to undertake a more detailed analysis of the real costs before proceeding with implementation of the Proposal. We would also point out an axiom of economics: There is no such thing as a free lunch. The costs borne by the financial services industry in complying with new regulations will ultimately be passed on to consumers of financial advice in the form of higher fees and other costs. We do not believe that Department has given sufficient consideration to this fact. The ultimate cost to investors will greatly outweigh the benefits. This is not in their interest.

**4. The Definition of "Fiduciary" in the Proposal is too broad**

In its present form, the Proposal would define virtually every form of communication between financial advisers and retirement savers as fiduciary in nature. This represents a significant departure from prior rules, and would include communications that should not reasonably be viewed by either investors or financial advisers as fiduciary in nature. For example, communications that heretofore have been viewed as educational would be considered fiduciary advice if they make reference to specific securities. Discussions between financial advisers and either plan sponsors or participants of 401(k) plans usually include a discussion of specific investment options, such as mutual funds or group annuity contracts, as illustrations. It is very difficult for plan sponsors and participants to understand these options without being able to view specific investments in the context of their composition and past performance.

We believe that a better and more effective option would be to limit the interactions that would be deemed fiduciary in nature to communications that recommend that the client undertake a specific action. A similar provision exists in FINRA Rule 2111, otherwise known as the "suitability "rule. Rule 2111 requires that any recommendation to purchase, sell, or hold a security made by a registered representative of a broker-dealer be suitable for the customer in light of several enumerated factors. A recommendation is defined as a "call to action" to the customer. If the communications between the customer and the financial adviser are preliminary and designed primarily to elicit information from the investor about their circumstances and objectives or to illustrate a possible investment scenario without suggesting a specific transaction, the client does not have a reasonable expectation that the adviser is acting as a fiduciary. Communications should not be considered fiduciary in nature unless they are intended to encourage the client to make a transaction.

**5. The Best Interest Contract Exemption (BICE)**

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The Department has stated its intent to allow financial advisers to maintain their current business practices and compensation models in adopting the Proposal. Its approach to this is in the BICE, which would create a class exemption for advisers who receive compensation in such forms as selling commissions, Rule 12b-1 fees, and revenue-sharing payments from third parties. Unfortunately, the conditions of the BICE are so onerous that many broker-dealers will not be able to avail themselves of them without radical changes to their current practices.

We have a number of concerns with the BICE, including the following:

- The BICE would require that an investor execute a written agreement prior to any form of communication with a financial advisor regarding investments. This is simply not consistent with the expectations of either clients or advisers. An investor arriving at an initial meeting with an adviser does not expect to be given a complicated, multi-page agreement regarding a potential relationship with the adviser and asked to execute it prior to any substantive discussion about their situation or needs. In our view, clients will be rightly suspicious of such an arrangement, especially since they are not likely to have any idea whether they wish to engage the adviser at that point. More likely, the client will be distrustful of the fact that the adviser insists on a contract prior to any sort of preliminary discussion and will decline to consult with the adviser at all. While we understand and endorse the desire of the Department to create a best interest standard, we believe that this provision is more likely to drive clients away from seeking advice of any sort and we do not believe that this serves their interest. Similar to our comments above regarding preliminary communications between advisers and clients, we suggest that a written agreement only be required when there has been a call to action from the adviser to the client to undertake an investment transaction. The securities industry and clients have long been accustomed to executing customer agreements at the point of sale, prior to the execution of any transaction. We believe that this is the more appropriate construct for any contract requirement.

- The BICE requires financial advisers to acknowledge in a written agreement that they are acting in a fiduciary capacity with respect to all covered accounts. In the preamble to the Proposal the Department states its view that the law governing fiduciary relationships is well developed and can be easily applied to these circumstances by the financial advisory industry. We believe that this is a gross oversimplification. In the United States, the law relating to the duty of fiduciaries is different in each of the 50 states and under federal law as well. In the past 20 years alone, Congress has enacted the National Securities Markets Improvement Act (NSMIA), the Private Securities Litigation Reform Act (PSLRA), and the Securities Litigation Uniform Standard Act (SLUSA). In adopting these laws, Congress has expressly recognized that the modern securities industry is national in scope, and needs a uniform standard across all jurisdictions in order to operate efficiently and provide the maximum benefit to the largest number of clients. While CFG

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supports a requirement that financial advisers act in the best interest of their clients, we believe that any such rule needs to be carefully drawn in order to prevent inconsistent application. Both the BICE and the Proposal should set forth a clear definition of the scope of the obligations of an investment advice fiduciary, and not leave that determination to the courts in 50 different jurisdictions.

- The BICE would limit access to entire classes of investment products. The Department has stated its' view that investments recommended to retirement savers must have an appropriate degree of transparency, liquidity, and marketability. It goes on to list asset types that would meet these standards, and specifically excludes a number of investment options.

  In establishing the list of "permissible" assets, the Department is doing a disservice to both customers and financial advisers. Indeed, we believe that by limiting the types of assets that advisers may recommend to clients, the Department is inadvertently sabotaging its own attempt to ensure that advisers act in the best interest of those clients. There is a great deal of academic research regarding returns on various asset classes that are illiquid or lacking in immediate marketability. Much of this research indicates that there is an "illiquidity" premium that attaches to such investments, and allows investors who do not need or desire immediate marketability to earn greater returns by investing in them. This is particularly significant in the context of investing for retirement, where most investors have multi-decade investment time horizons. The very nature of tax-qualified accounts is such that the funds stay invested for very long periods of time and are withdrawn on a predictable schedule. Liquidity is generally a desirable feature in any investment, but it comes with a cost. Investors should be allowed to make this tradeoff if they choose.

  We also understand and agree with the Department's desire for transparency in retirement investments. This has been a fundamental principle in securities law for more than 75 years in the United States. However, there is already a very well developed disclosure regime for securities that are registered with the SEC, and which provides for the very transparency that the Department seeks. We submit that the Department can accomplish its aims simply by requiring that securities that are recommended by financial advisers relying on the BICE be registered with the SEC under the provisions of the Securities Act of 1933.

- Under the current version of the Proposal, the definition of "fiduciary" would change as of the effective date for any new regulation. At that time, many financial advisers would immediately need to rely on the BICE in order to continue to provide advice to their clients with respect to existing securities holdings. This creates a number of unfortunate and, we believe, unintended consequences. For example, it would require financial advisers to obtain a written agreement from the client **before providing any further**

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**advice**. If the client has holdings that are not included in the list of permissible assets under the BICE, the adviser could not rely on the BICE and would be forced to cease providing advice to the client with respect to those assets. We therefore believe that the BICE should provide for "grandfathering" of all client accounts and securities holdings in existence prior to the effective date of any new regulation.

- The BICE contains numerous provisions requiring financial advisers to provide extensive amounts of information to customers. Included among the required data elements are point-of-sale and annual summaries of costs and expenses related to each individual securities holding in a client's account. In addition, advisers would be required to provide projections for multiple time periods extending as long as 10 years relating to all costs and expenses that the client would pay in connection with ownership of each security.

  Client portfolios may contain tens or even hundreds of individual assets. Particularly with packaged products such as mutual funds and variable annuities, there are multiple types of expenses attributable to each. For example, a variable annuity contract may include a fee for insurance features such as death benefits (mortality and expense), fees for riders such as living benefit payments or guarantees, individual fund management expenses, selling commissions, revenue-sharing payments, and potentially others. This raises a number of concerns:

  - Financial advisers such as broker-dealers do not currently assemble or maintain all of the information that would be required. In many cases, they would not have direct access to this data, and would be forced to construct mechanisms to obtain it from literally hundreds of sources. A typical broker-dealer that services a retail client base might offer hundreds of different mutual funds and annuity contracts, each with its own specific costs and expenses. Firms would be required to deal with hundreds of different information providers such as mutual fund sponsors and annuity issuers to obtain this information.

    The recent experience with implementation of the regulations under ERISA Section 408(b)(2) is instructive on this point. The information required by those regulations related only to certain ERISA-covered plans. The BICE would cover literally millions of IRA accounts and participants, and would require delivery of more information about a vastly increased number of accounts and transactions. The effective date for implementation of the regulations under Section 408(b)(2) was delayed on several occasions, we understand in large part due to logistical difficulties that financial advisers encountered in acquiring and delivering this information. The Department has stated an intent to make new regulations under the Proposal effective 8 months after final publication. We believe that this is a completely unrealistic

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timeframe that no financial adviser will be able to comply with. At a minimum, the effective date for any such provision must be extended to at least 36 months.

- As the SEC and FINRA have long realized, projections of future expenses and investment performance depend on many variables and are inherently difficult to do accurately. Especially given the ten-year time period specified in the BICE, the information provided is likely to be so voluminous, granular, and speculative that it will be of little or no practical use to investors.

- Investors who have more than a few securities holdings will be deluged with so much information about the costs and expenses associated with them that the data provided to them will become meaningless. We agree that investors should be informed about all aspects of the compensation that advisers earn in connection with the sale of investments and provision of investment advice. However, breaking this down into every security owned by every client will be enormously expensive and will not lead to investor protection benefits that are commensurate with the cost.

## Conclusion

CFG has devoted considerable time and effort to review of the Proposal and the outcomes that it may produce. For the reasons stated above, we have serious concerns about the effect that it will have on both investors and financial advisers. We are convinced that, despite the good intentions of the Department, adoption of the Proposal will serve to increase the cost and barriers to receiving retirement-related investment advice, especially for investors with relatively modest account balances. This will prove to be counterproductive to the goals of the Department and to retirement savers. We strongly urge the Department to take these comments into account in developing any new regulations and preventing unintended consequences.

We welcome the opportunity to work constructively with the Department in refining it's understanding about these important issues. If you have questions about anything herein or we may provide any further information, please do not hesitate to contact me.

Yours very truly,

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