From: New Constructs, LLC

Sent: 3/14/17

To: EBSA Fiduciary Rule Examination

Subject: RIN 1210-AB79

To Whom It May Concern:

New Constructs submits the following comments regarding the Department of Labor's proposed rule entitled *Definition of the Term "Fiduciary" - Delay of Applicability Date.*

General Comments

We applaud the Department of Labor for raising awareness of the importance of fiduciary standards. No matter the final legalities, countless investors are better equipped to navigate financial markets by knowing their right to a fiduciary level of service. Few would argue against the idea that all advisers should act in their clients' best interests. Investors are better served, and the investing business has more integrity, when the fiduciary level of service is applied. Investors want advice that is aligned with their best interests. No adviser wants to be perceived as not having the clients' best interests top of mind.

However, many people throughout the industry are still unclear as to how the fiduciary rule should be implemented. This uncertainty, at least In part, is behind many industry groups working hard to delay—or even scrap entirely—its implementation.

Call To Action

In its first two FAQs on the new fiduciary rule, the DOL covered key topics such as conflicts of interest, exemptions, and investor rights. In the third FAQ, we humbly suggest the DOL provide guidance on exactly how advisers apply proper due diligence and meet the fiduciary standard when making investment recommendations.

Defining diligence is probably the hardest part of implementing the fiduciary rule, but it brings important upside. It could alleviate significant compliance concerns from advisers and wealth management firms. It would also reassure investors that they are getting proper value for their fees, support the integrity of the markets, and promote the development of more high-quality investment research to better serve advisers and investors.

It's important to note that diligence does not guarantee investors will always make money. Nor does requiring diligent research for investment recommendations guarantee that investors won't get duped by advisors. it does, however, provide legal resource if the advisor acts contrary to the client's best interests.

To the extent we can be helpful, we'd like to share what we've learned from our research and meetings with key constituents across the wealth management space.

Defining diligent research

To start, there is absolute agreement that research that meets the fiduciary standard should be 100% unconflicted and, inarguably, in the best interest of the client. To put a little more meat on that bone, we think truly diligent research should be:

• **Comprehensive.** All relevant publicly available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including the footnotes and the Management's Discussion & Analysis (MD&A).

• **Objective.** There must be empirical analysis that supports the research and recommendation.

• **Transparent.** Users should be able to see how the analysis was performed and the data behind it.

• **Relevant.** There must be a tangible, quantifiable connection to stock, ETF or mutual-fund performance.

Diversification isn't a substitute for 'diligence'

By law, a fiduciary must act with "care, skill, prudence, and diligence." The law also suggests diversification as a safety measure to avoid concentrated risk.

Certainly, diversification may reduce some risk, but, if we learned anything from the mortgage crisis, we know that investing in lots of bad securities can yield the same results as investing in a few bad securities. Diversification only shows diligence if an adviser has acted with "care, skill, prudence, and diligence" in his/her research of the securities into which he/she recommends investing.

Diligent Research Is Hard To Find

We freely admit that doing proper diligence is easier said than done. If there were an obvious off-the-shelf source for diligent research, we'd likely not see the pushback we've seen for the new rule.

The DOL's timing for this new rule could not be better considering how hard it is get diligent research today. For starters, there's the declining signal/noise ratio for investment research. Between CNBC, Fox Business News, and a myriad of online and offline publications, there are more opinions and research reports/articles than ever.

Relying on sell-side research can also be risky. While these reports often contain valuable information, the analysts/firms that write them may be compromised in a myriad of ways. If the DOL wants to discourage conflicts of interest (inarguably a problem for the integrity of the investing business), then sell-side research should probably play a less prominent role in developing and justifying investment recommendations.

Doing diligence oneself is not a reasonable solution for most investors/advisors either. Accounting rules and disclosures have become more complex and financial filings longer than ever. Who has time to read, analyze and model financial data from 10-K and 10-Q reports that are more than 200 pages on average?

Many traditional short-cuts like the P/E ratio and ROE have proven ineffective over time. Investors should also beware of research that claims to offer more sophisticated metrics as it is often plagued by inconsistencies and flawed methodologies.

You Know It When You See It

While there may not be an obvious all-encompassing solution for diligent research, the DOL has already undoubtedly and meaningfully improved the integrity of the capital markets by shining a light into the dark corner of investment research.

The lack of a readily apparent solution should not deter the DOL's advocacy for diligent research. We support the DOL's approach to improving investment research thus far. We do not see the need for new rules or regulations, rather enforcement and application of existing rules, like the fiduciary rule, will suffice. All grandstanding aside, who can argue against the merits of more closely aligning the best interests of investors with the wealth management industry?

The DOL need not provide proscriptive details on what diligent research is. We think guidelines like what we propose above will easily suffice.

Investors recognize diligent research when they see it. There are many research firms doing good work and providing diligent research, and our free-market economy will ensure their prosperity as long as diligence remains a priority. When diligent research thrives, so does the integrity and prosperity of the markets.

The DOL has an opportunity to give meaningful clarity to the investment community in its next set of FAQs. We hope it does so.

Specific Comments

1. https://www.federalregister.gov/d/2017-04096/p-80
    a. What innovations or changes in the delivery of financial advice have occurred that can be at least partially attributable to the rule? Will those innovations or changes make retirement investors better or worse off?
    b. Comment: Need is the mother of invention. To the extent wealth management firms create more demand for fiduciary-level research, more of it will be developed. The idea of a robo-analyst to complement both advisors and robo-advisors speaks to a specific technology need that would gain momentum were the DOL to proceed with this rule. These improvements will undoubtedly make retirement investors better off. Traditionally, investment recommendations have been

based too much on research that is at risk of being conflicted or that is based on technical analysis. Investors deserve better. It is hard to argue otherwise.

2. https://www.federalregister.gov/d/2017-04096/p-81
    a. What changes have been made to investor education both in terms of access and content in response to the rule and PTEs, and to what extent have any changes helped or harmed investors?
    b. Comment: We applaud the Department of Labor for raising awareness of the importance of fiduciary standards. No matter the final legalities, countless investors are better equipped to navigate financial markets by knowing their right to a fiduciary level of service. As more wealth management firms (e.g. Merrill Lynch and Fidelity) embrace offering the fiduciary standard of service as a competitive advantage, they will likely advertise how this offering differentiates them from firms that do not provide the fiduciary level of service. This advertisement will serve as education for investors. This education, incontrovertibly, helps investors.
3. https://www.federalregister.gov/d/2017-04096/p-64
    a. economic theory that predicts harmful market failures due to the information asymmetries that are present when ordinary investors rely on advisers who are far more expert than them, but highly conflicted
    b. Comment: The best way to fix information asymmetries is to eliminate them. Exploiting information asymmetries seems to conflict with providing a fiduciary level of service. Moreover, we believe that making truly diligent research, as defined above, available to more (hopefully, all) investors puts more (or all) investors on fairer footing with those who have traditionally benefits from information asymmetries. In other words, requiring a fiduciary level of service will precipitate the propagation of research that supports such service, and proliferation of such research increases the number of appropriately informed investors, which decreases the potential pervasiveness of information asymmetries. As a consequence, market failures are less likely. We would add that capital markets would, in general, be more efficient as well.

Thank you for the opportunity to comment on this important rule.

Sincerely,
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FASB Investor Advisory Committee
Twitter
Author of “Modern Tools for Valuation"

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