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Via submission to the rulemaking portal:
www.regulations.gov
Docket ID number: EBSA-2020-0003.

August 6, 2020

Office of Exemption Determinations
Application No. D-12011
U.S. Department of Labor, EBSA
Office of Exemption Determinations
200 Constitution Avenue NW,
Suite 400
Washington, DC 20210

Re: ZRIN 1210-ZA29 [Application No. D-12011]
"Improving Investment Advice for Workers & Retirees"

Ladies and Gentlemen:

I write on my own behalf to express my severe concerns regarding the relaxation of ERISA's high standards of conduct, and the non-application of the fiduciary standard, as proposed by components of the proposed rule. I am a registered investment adviser and Certified Financial Planner™ who often provides advice to participants in ERISA-covered plans. I am also an attorney, university professor,[1] and a researcher and writer/presenter on topics relating to the application of fiduciary duties to the delivery of investment and financial advice and recommendations. As a university professor, I have taught classes in Retirement Planning, Applied Investments, Advanced Investments, Insurance and Risk Management, Business Law, and Money and the Capital Markets, as well as several other classes relating to topics in financial planning. I have also served as a consultant to broker-dealer firms. As a result of my unique perspective, I believe my comments can assist the U.S. Department of Labor to effect a more reasoned rule-making.

1. **<u>The Time Permitted to Develop and Provide Comments Is Not Sufficient.</u>**

The Employee Benefits Security Administration ("EBSA") had this proposed regulation published in the Federal Register, and the U.S. Department of Labor ("DOL") only provided 30 days to submit comments on the proposed rule, an insufficient time for the American public to review and respond to a complex, 123-page proposed rule. I hereby incorporate by reference my prior submission of July 7, 2020, expressing my concerns that this limited period of time, especially during a pandemic, does not meet the requirements of the Administrative Procedure Act's ("APA"). Under the APA, agencies are required to provide the public with adequate notice of a proposed rule followed by a meaningful opportunity to comment on the proposed rule's

[1] This letter, and my views contained herein, are submitted on my own behalf, and do not necessarily represent the views of any university, other institution, organization, nor firm in which I have or currently am involved.

content. *See Rural Cellular Ass'n v. F.C.C.*, 588 F.3d 1095, 1101 (D.C. Cir. 2009) *(citing Gerber v. Norton,* 294 F.3d 173, 179 (D.C. Cir. 2002). This includes giving "interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments…." 5 U.S.C. § 553(c). Courts have emphasized that the APA's notice and comment requirements "serve important purposes of agency accountability and reasoned decision making" and impose a significant duty on the agency" to allow for meaningful and informed comment." *Am. Medical Ass'n v. Reno*, 57 F.3d 1129, 1132-133 (D.C. Cir. 1995). Given the unreasonably compressed time to comment on this proposal, I have not possessed a meaningful opportunity to research the law and the economic impacts, and to submit written data to properly inform this rulemaking. Nevertheless, I will submit what comments I can; however, these comments are necessarily less substantial, in both number and in terms of explanation and supporting argument, than previous comment letters I have submitted to the DOL and to the SEC on their fiduciary regulation and Regulation Best Interest and related rulemaking proposals, given the very limited time provided to analyze the proposed rule.

2. **The Proposed Rule Thwarts the Will of the U.S. Congress.**

The plain language of ERISA establishes a multitude of protections for plan participants in ERISA-covered defined contribution plans, including fiduciary duties, the prudent investor rule, and the prohibited transaction rules. ERISA-covered retirement plans possess tax advantages. In addition, the U.S. Congress has long recognized, under ERISA and its various amendments, the need to ensure protection to plan sponsors and to plan participants. The proposed rule guts these protections, effectively (and especially by the release's pointing to the use of Regulation Best Interest, a non-fiduciary standard of conduct for broker-dealer firms and their registered representatives) gutting the protections which the U.S. Congress expressly mandated be in place and maintained for ERISA-covered plans.

3. **The Proposed Rule Violates the Requirements for a Class Exemption, Generally.**

Generally, the proposed rule violates long-standing interpretations of ERISA by granting a class exemption from ERISA that is not in "the interest of" plan sponsors and investors in retirement plans and IRAs, and which is not "protective of the rights" of such plan sponsors and investors.

Generally, the proposed rule ignores the established fact that no man can wear "two hats," and that operating as a fiduciary to a qualified retirement plan, or in adherence to the requirements of the class exemption from the prohibited transaction rules, cannot be practically accomplished (without substantial transgressions occurring) when investment product sales are undertaken.

The "sole interests" fiduciary standard of ERISA can be modified by a class exemption, but under long-standing legal principles only if the "best interests" fiduciary standard is applied in a manner protective of the interest of plan sponsors and plan participants. The proposed class exemption does not meet the requirements of the "best interest" fiduciary standard of conduct, which requires that any conflict of interest not merely be disclosed (as Regulation Best Interest's non-fiduciary standard of conduct effectively only requires, and under which the DOL states this class exemption will be interpreted). There is no requirement under the DOL's proposal – as it is to be interpreted according to the DOL – that any resulting conflicts of interest be properly managed in order to meet the "best interests" fiduciary standard and the requirement that the interests of the plan sponsors and plan participants be protected.

The Secretary of Labor's statement in a press release regarding the proposed rule, "Today's proposed exemption would give Americans *more choices* for investment advice arrangements, while protecting the retirement savings of American workers" is a *red herring*. The purpose of the fiduciary standard is to restrain inappropriate conduct – by eliminating poor choices for investors. One of the main tenants of the prudent investor rule as applied under ERISA is to ensure assets of plan participants are not wasted. By permitting conflict-ridden advice to be provided by fiduciary advisors, the Secretary of Labor does not protect Americans' retirement savings, but instead protects the interests of Wall Street and insurance companies to the detriment of tens of millions of Americans, who will see a significant decline in the value of their retirement accounts due to the waste of their hard-earned assets.

4. <u>The Proposed Rule Fails to Consider Many, Many Alternatives.</u>

Such alternatives include, but are not limited to:

A) An application of the fiduciary standard of conduct to all those who, by virtue of their actions, enter into a relationship of trust and confidence with the plan sponsor and/or plan participants. The common law application of fiduciary standards should inform the DOL's rulemaking, but has been wholly disregarded.

B) While the academic research disclosures are largely ineffective in the realm of the provision of investment advice, as to both plan sponsors and plan participants, they can possess mild positive impacts. The proposed rule fails to explore the alternative that all plan sponsors and/or plan participants, when receiving advice or recommendations regarding investments, be informed in writing: (1) as to whether the person and/or firm providing such advice or recommendations is, or is not, a fiduciary; (2) that a plan sponsor is at greater risk of liability when he/she/it relies upon non-fiduciary advice, given the limitations of liability upon broker-dealers and insurance agents and their representatives due to the application of the weak "Regulation Best Interest" and "suitability" standards; (3) that no undue reliance should be placed upon a non-fiduciary provider of investment recommendations, given the arms-length nature of the relationship and the application of caveat emptor (modified only by weak conduct standards applicable to broker-dealer firms and their registered representatives).

C) The proposed rule fails to consider whether the language of ERISA should simply, and forthrightly, be applied to determine when a fiduciary relationship exist, rather than through the re-application of the distorted "five-part test," which test runs counter to the express language of ERISA.

D) The proposed rule fails to consider whether the"best interests" fiduciary standard of conduct applicable to class exemptions, which is lower than ERISA's default "sole interest" fiduciary standard, should be applied in a manner in which conflicts of interest and their potential ramifications to the entrustor are affirmatively disclosed, that entrustor understanding is assured, that informed consent be obtained, and even then the conflict of interest must not result in a transaction which is substantively unfair to the entrustor. The proposed rule fails to recognize that no *informed consent* can be present, under the best interests fiduciary standard applicable to class exemptions under ERISA, if the entrustor would be harmed by a transaction. And, as is well-established by the academic evidence, higher fees and costs borne by investors result in harm to investors, as the result of lower investment returns.

As a result, the proposed rule does not reflect a "fair and considered" judgment of the agency, as so many alternatives were not examined by the Agency.

5. **<u>The proposed rule, by incorporating Reg BI as the means for its interpretation, and by permitting numerous conflicts of interest to exist, does not meet the requirements of ERISA, and effectively negates ERISA's long-standing interpretation of the duties of an ERISA fiduciary to conduct a "intensive and scrupulous" and "independent" investigation "with the greatest degree of care."</u>** *See, e.g., Donovan v. Bierwirth,* 538 F. Supp. 463, 470 (E.D.N.Y. 1981), *order modified by* 680 F.2d 263, 269 (2d Cir. 1982) (Independent investigation into basis for investment decision which presents potential conflict of interest must be both intensive and scrupulous and must be discharged with greatest degree of care that could be expected under all circumstances by reasonable beneficiaries and participants.)

6. **<u>The proposed rule, by permitting commissions and 12b-1 fees to be received by a person acting in a fiduciary capacity, violates the regulatory regime established by Congress for broker-dealers and for registered investment advisers, and their separation of function, since 1940.</u>**

7. **<u>The Proposed Rule Substantially Fails in Its Economic and Investment Analysis.</u>**

The added costs borne by plan participants, as a result of actions which will follow from the proposed rule, will result in unreasonable compensation in many instances to providers of investment recommendations to the plan, a violation of the plan sponsor's fiduciary duty of due care, and will not meet the requirements for a class exemption from the prohibited transaction rules as set forth by statute.

a. **The proposed rule does not reflect the reality of economic incentives, as to the provision of poor advice**. By permitting a substantial increase in the conflicts of interest, the proposed class exemption provides incentives for investment advice fiduciaries to recommend higher-cost investment products. The simple truth is that economic incentives drive behavior. By providing the ability of fiduciary advisers to receive differential compensation, depending upon the investment products recommended, economic incentives result that will propel the use of higher-cost investment products in retirement plans.

b. **The proposed rule does not reflect the reality that higher-cost investment products will be provided as a result of the rule, and this will substantially reduce the returns to investors**. The academic research is clear - higher-cost investment products result in lower returns for investors.

c. **The proposed rule fails to consider that defined contribution plans covered by ERISA, such as 401(k) plans, possess economies of scale.** As a result, the costs relating to the selection and monitoring of investments for the retirement plan can be spread over all of the plan participants.

d. **The proposed rule fails to take into consideration that commission-based compensation is inappropriate under Modern Portfolio Theory, for individual funds.** The typical sales commission of a Class A mutual fund, when provided to an investor in a 401(k) plan, will be 5.75%. The impact of this commission is huge, especially over a limited period of time, and even over long periods of time. Under Modern Portfolio Theory, rebalancing is required to maintain the investor's strategic asset allocation, or when tactical asset allocation decisions are undertaken. The proposed rule fails to consider the costs of a new 5.75% commission due to such rebalancing actions. This will substantially reduce the returns to investors. I note that the average holding period of all mutual funds is less than 4 years, according to various surveys.

e. **The proposed rule fails to take into consideration that Class C shares, which typically possess a 1.00% 12b-1 fee, possess exorbitant fees for a defined contribution plan**, especially since investment advice is provided by defined contribution plans via group educational meetings, web-based tools and educational materials, and only rarely in one-on-one advisor-participant meetings.

f. The proposed rule fails to take into consideration that 12b-1 fees do not benefit fund shareholders, and can over the course of many years result in unreasonable compensation to the provider of investment recommendations.

g. **The proposed rule fails in its economic analysis by failing to consider the huge increased liability plan sponsors will bear due to the receipt of investment advice that is not fiduciary advice.**

(1) Non-fiduciary "retirement plan consultants" and others will increasingly provide recommendations to plan sponsors, as a result of the proposed rule.

(2) Plan sponsors rely upon such recommendations.

(3) Yet, plan sponsors are not investment specialists, nor trained in the application of ERISA's standards, the prudent investor rule, Modern Portfolio Theory, the ability to discern and compare the benefits, costs, fees, and risks present with regard to mutual funds and other pooled investment vehicles, as well as different types of annuities and guaranteed investment contracts.

(4) This investment advice and investment recommendations provided to plan sponsors under the proposed rule will often fail to meet the requirements of the prudent investor rule, particularly as to its requirement to not waste the assets of plan participants.

(5) Plan sponsors will be increasingly sued by plan participants, via class action claims.

(6) In such litigation, the "retirement plan consultants" and others who are not fiduciaries (as a result of application of the proposed rule) will be able to hide behind the low standard of conduct applied under the SEC's Regulation Best Interest, and will be dismissed from the litigation and absolved from any accountability for their recommendations.

(7) Plan sponsors, who are business owners large and small, and who lack their own expertise to adhere to the requirements imposed by ERISA, will incur huge costs to plan participants due to the inappropriate, conflicted investment recommendations they received from such non-fiduciaries. Plan sponsors will be held liable for breaches of their obligations under ERISA, while under the proposed rule more and more providers of conflicted advice will not be so liable. Plan sponsors – U.S. corporations large and small – will incur liabilities to their plan participants in aggregate amounts, over time, of hundreds of millions of dollars, or even billions of dollars.

h. **The proposed rule fails in its economic analysis by failing to consider the increased deterrence effect to plan sponsors who might otherwise desire to initiate and/or maintain defined contributions plans for their employees.** The proposed rule fails to consider the increased liability which will certainly result upon plan sponsors (corporations), who possess non-waivable fiduciary duties – not only in terms of the huge adverse financial impact from class action litigation, but also the deterrence effect upon other corporations – to start defined contribution plans covered by ERISA – due to the potential liability. This further endangers the retirement security of many Americans, which the U.S. Congress through its adoption of ERISA desired to effectively address by means of providing numerous protections under ERISA to plan sponsors and to plan participants.

i. **The proposed rule fails in its economic analysis by failing to consider the negative impact on the budgets of federal, state, and local governments.** Increased burdens will result on governments to provide for their senior citizens, as a result, through governmental programs such as Medicaid, food assistance, low-income housing assistance, etc.

j. **The proposed rule fails in its economic analysis by failing to consider the impact of higher fees and costs on capital accumulation and U.S. economic growth**. The higher fees and costs incurred by plan participants will lower the amount of retirement savings. In addition, by providing for the receipt of conflicted advice by plan participants and IRA account owners, those individual investors - who studies have shown rely upon the advice they receive - will see their interests betrayed. As a result, they will lose trust in our financial system of investments, and withdraw their capital from the capital markets. This will decrease the availability of capital, with an increasing impact over time. This raises the cost of capital to American business. In turn, this will severely impair future U.S. economic growth.

8. **The proposed rule is contrary to the requirement that plan sponsors and other fiduciaries must act in accordance with the prudent investor rule with respect to retirement plans covered by ERISA.** Under Title I of ERISA, plan fiduciaries must act prudently and with undivided loyalty to employee benefit plans and their participants and beneficiaries. The proposed exemption will permit fiduciary advisors to provide advice which does not meet the prudent inventor rule.

9. **By leading to widespread confusion, the Rule is ambiguous (and nonsensical), on its face, especially as a result of inclusion of the DOL's interpretation (via the application of Regulation Best Interest to interpret the "best interest" fiduciary standard applicable under ERISA and the requirements for a class exemption from the prohibited transaction rules) that runs directly counter to the express language of the Rule. The Rule is, accordingly, not a proper exercise of agency rule-making, as it is not rational; it is arbitrary and capricious**. The Rule, together with the proposed Agency interpretation that directly contradicts the express language of the Rule, will cause great confusion in the industry. The interpretation made by the agency is not a reasonable interpretation. The DOL's interpretation falls outside the DOL's expertise, as the DOL has no expertise in Reg BI, which just became effective on June 30, 2020 and is just now being beginning to be interpreted by the SEC. Moreover, the DOL has no greater expertise, relative to that of a court, in applying common law fiduciary standards of conduct

Again, there are many additional flaws with the proposed rule, which I would seek to further discern and comment upon, if sufficient time for a thorough analysis of this proposed rule had been provided by the DOL. This area of rulemaking is complex, with regard to the application of ERISA's fiduciary or non-fiduciary status, fiduciary standards of conduct ("sole interests" vs. "best interests"), ERISA's prohibited transaction rules, and the requirements of class exemptions from the prohibited transaction rules. The inclusion of references to the ambiguous Regulation Best Interests, from the SEC, as a means for interpretation of certain requirements in the DOL's proposed rule, and at a time when the term "best interests" has not been defined nor adequately interpreted by the SEC, further complicates the analysis of the DOL's proposals.

Regardless, however, it is abundantly clear that the DOL, through this proposed rule, disregards fundamental economic analysis as to many impacts of the rule, seeks to thwart the will of the U.S. Congress, fails to even state much less adequately consider many alternatives that should have been explored in the rule-making processes as required by the APA, and generally disregards the plan language of ERISA.

The DOL effectively seeks to gut the protections of ERISA which are provided to plan sponsors and plan participants, and in so doing would reduce ERISA to an empty shell into which conflict-ridden product sales practices will creep, at great harm to individual Americans, Americans' retirement security, and the accumulation of capital for use in American businesses. In short, this proposed rule possesses major economic impacts, and if adopted the DOL's proposed rule will endanger the very economic health of our nation.

The DOL should formally withdraw its proposed rule, do its job, and then move (through careful exploration of the alternatives, careful consideration of the will of the U.S. Congress as expressed in the plain language of ERISA, and with due consideration of the practical and economic impacts) formulate a new proposed rule that meets the many statutory requirements of ERISA and the APA.

Sincerely,

Ron A. Rhoades, JD, CFP®