



# Occupy the SEC

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July 21, 2015

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

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

Dear Sir or Madam,

Occupy the SEC (“OSEC”)<sup>1</sup> is pleased with the efforts of the Department of Labor, Employee Benefits Security Administration (“DoL”) to address the problems that have accompanied the emergence of participant-directed retirement investment accounts. These efforts are critical to a fair and robust investment environment and we commend the Agency’s generally thoughtful proposal.

The DoL’s proposed fiduciary rule is a vital change because it reflects a basic market *reality*: investors (and even sponsors and plan employees) believe that professionals providing retirement advice have the investor’s *best interest* in mind. No amount of disclosures or disclaimers will change the fundamental trust that investors place on advisers. Another unfortunate market reality is that many retirement advisers do *not* uniformly have the investor’s very best interest in mind, for the simple fact that that is not legally required under the current suitability standard. A strong fiduciary rule is necessary to bridge the gap between investor expectations and the law.

We write to recommend that the Agency set forth a clear rule that minimizes exceptions to the applicability of the fiduciary standard. As explained below, a proper understanding of the term “fiduciary” does not countenance the number of exemptions crafted by the DoL in the Proposed Rule. The Agency must avoid adopting a Janus-faced

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<sup>1</sup> Occupy the SEC (<http://occupythesec.org>) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.

approach that pays lip-service to the heightened fiduciary standard while concomitantly imprecating that standard with sweeping exemptions that resurrect the old suitability standard.

The Final Rule should especially safeguard the interests of plan participants/beneficiaries and IRA Holders. The rule should also (within the scope of existing law) broadly cover entities as investment advisors. The Final Rule should harmonize with existing fiduciary requirements while accounting for the unique characteristics of the fissured ERISA service provider environment. Ultimately, the rule should establish clear standards that facilitate compliance and obviate the need for Agency and other enforcement actions for misconduct.

First and foremost, the Rule must protect investors. In a market characterized by lowered returns and risky instruments, plan participants, beneficiaries, and account holders are vulnerable to heightened fees and highly-leveraged investments that not only threaten the security of individual accounts but also the employment security of beneficiaries and IRA holders. The Agency must account for these considerations in determining the final structure of the Rule.

## **I. Background**

The current environment is one in which the dramatic growth in participant-directed funds has unfortunately been coupled with instability and weakness in the global environment for investment. These changes are largely linked with the demise of aspects of the traditional employment environment such as defined-benefit pension programs and employment stability.

The instability of highly leveraged and otherwise risky investments poses an additional, if unpredictable, cost to the performance of funds and therefore justifies issuance of a strong fiduciary regulation. As the Agency acknowledges in its Proposed Rule, researchers have produced evidence that a reliance on the current framework for coverage of financial industry products has resulted in impoverishment of retail investors in the retirement account arena. Risky investments have consequences and, in a time of submerged investment earnings and prolonged quantitative easing (QE), it may appear that these consequences are higher rates of return in the short and medium term. But the lesson of the Financial Crisis of 2008 (and, on a smaller scale, the Enron collapse) is that regulations must not encourage the growth of highly-leveraged instruments that are traded in opaque markets that promise to become illiquid in the event of a downturn in asset values. The growth of such instruments only increases the probability of a tail-risk event that can devastate investors' savings. The financial contagion from such an event can produce a systemic downturn that even impacts traditionally less-troublesome equities. Thus, it must be recognized that allowing free reign to investment advisors can result in market-wide misallocations of capital, which in turn can produce weak business investments and unstable economies.

There are concomitant risks for beneficiaries and IRA holders *qua* workers as this system makes earned income unstable and may limit the ability of 401(k) beneficiaries and IRA holders to have control over both their workplace earnings and retirement savings. It would be inappropriate and sadly ironic for workers' invested earnings to facilitate financial market activities that foment instability and increase the possibility of

a debilitating financial crisis, even as they finance the evisceration of traditional labor relationships.

These market conditions require a rule that is clear, free of unnecessary exemptions, and simple for participants and beneficiaries to enforce.<sup>2</sup>

## **II. Coverage Under the Proposed Rule**

In order to fully protect investors, the fiduciary rule should broadly cover as many investment advisers not currently subject to fiduciary duties as possible. It is critical that the rule's definitional terms be set forth to ensure that myriad small providers acting as financial advisors are subject to basic requirements of client protection. The rule, in addition, should harmonize with fiduciary frameworks in ERISA and the securities and commodities laws, while accounting for the unique vulnerabilities of ERISA participants and IRA holders, in order to prevent continued evasion of basic investment advisor duties.

In tandem with that broad coverage, the rule should not carve out exclusions from coverage based on a misplaced concern for innovation and flexibility. The retirement account market is rife with conflicts of interest as well as increasing risks posing significant costs to retail investors. A weak fiduciary rule that allows continued subterfuge regarding the duties of contractors and subcontractors will only condone the very conditions that the DoL has recognized cause losses for retail investors. An exception-laden rule may benefit individual firms and actors within the financial industry, but would fail to provide any corresponding benefit to the macroeconomy or the financial system as a whole.

In general, we strongly support the rule's broad requirements that a service provider be treated as a fiduciary if the entity provides certain types of investment advice to the plan or IRA Holder (and similar retirement vehicles such as Health Savings Accounts (HSAs)), under specific conditions, and the provider directly or indirectly receives a fee or compensation for that advice. The investment advisor either directly or indirectly must also either (1) provide advice under an agreement, arrangement or understanding that is "individualized" to or specifically directed to the recipient "for consideration" in making investment or management decisions with respect to securities or other property of the plan or IRA or (2) represent or acknowledge that it is acting as an ERISA fiduciary with respect to the advice. As the Proposed Rule and supporting documents make clear, the existing rule fails to account for a retirement marketplace in which widely varying services and entities, including consultants, advisors, and appraisers, collaborate to provide guidance to sponsors, plan beneficiaries, and IRA holders. The new rule finally recognizes the economic reality of fragmented service provision and the possibility that evolving identities of providers will not reflect their function.

As the Department of Labor proposes, the revamped rule should cover advice as to several events, including recommendations relating to:

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<sup>2</sup> While risk mitigation is more aptly the province of other financial regulators, we nevertheless stress, that the Agency, in elaborating on the fiduciary requirements of plan advisers, should emphasize that heightened risk-taking by advisers may not comport with the fiduciary standard.

- a) the acquisition, holding, disposition, exchange, distribution or rollover of assets,
- b) the management of assets to be rolled-over or distributed from an IRA, and
- c) who will receive a fee or compensation for providing those services.

In addition, as the DoL proposes, the rule should cover recommendations of professional investment advisers or plan managers and appraisals or fairness opinions concerning the value of property given in connection with a particular transaction relating to the acquisition, disposition or exchange of assets. These are key pressure points at which investment advisers have extracted value from retirement accounts without providing any corresponding benefit to plan beneficiaries, IRA holders, or even sponsors. A broad fiduciary rule will help counteract such undue value extraction.

Industry advocates may raise concerns that some entities providing limited or tangential services will be ensnared in the proposed regulatory scheme with significant compliance costs but few benefits. We acknowledge that these concerns may be partially legitimate. In a Wild West of advisors profiteering and looting from retail investors, however, the current rule establishes a grossly wanting standard, only requiring that investment advice serving as a primary basis for an investment decision be regular, individualized, and provided pursuant to mutual agreement, arrangement or understanding. The current rule fails to cover an important range of circumstances. For instances, the DoL ruled as recently as 2005 that the rule excludes from the scope of fiduciary duty such core activities as providing a recommendation as to the distribution and reinvestment of plan assets.<sup>3</sup>

In order to avoid circumstances in which entities with similar functions may plausibly fight coverage under ERISA, the DoL must act to preserve its jurisdictional ambit. Key terms such as “advice,” “individualized,” “specifically directed,” “fees,” “compensation,” and “recommendation” must be broadly defined to prevent gamesmanship in this universe of tangentially connected service providers. We continue to be concerned that the terms “individualized” or “specifically directed” advice create a loophole in fiduciary applications. For instance, if all employees of the sponsor or administrator put all of their money into a risky investment after an option is provided or suggested, this act should be accounted as a fiduciary act under Section 3(21) of ERISA. As the Agency recognizes, other commentators have suggested that the application of the fiduciary rule is unclear where an entity managing multiple funds provides generic suggestions about fund preferences. A broader definitional ambit will empower the DoL to winnow out culpable conduct from more benign activity during complex enforcement actions involving multiples parties.

### **III. Exceptions**

In 1928 Judge Benjamin Cardozo famously defined the fiduciary standard as follows:

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<sup>3</sup> DOL Advisory Opinion 2005-23A (Dec. 7, 2005).

[a] trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.<sup>4</sup>

The DoL falls far short of this mandate because the large number of exemptions that it has proposed undermine the rule's vitality. In today's highly complex financial markets, the size or sophistication of an investor (or investor representative) is often irrelevant. Purveyors of complicated, Frankenstein-esque financial instruments are privy to insider information that is not available to anyone else. As numerous incidents from 2008 have revealed, such purveyors have all-too-often exploited that information advantage to the detriment of even their most sophisticated "clients."<sup>5</sup>

The fiduciary standard is needed because it protects retirement investors and their representatives from having to fend for themselves. These beneficiaries are not in the best position to know if proffered advice is in their best interest – rather, they are entitled to *expect* that it is. The fiduciary standard enshrines that expectation in law. Unfortunately, the DoL's numerous carve outs and exceptions to the proposed fiduciary rule undermine the rule in significant ways.

#### A. *Investment Education Carve Out:*

Although, in the abstract, we acknowledge the justification for an investment education carve out, in practice there are lingering concerns about the quality of such "educational" investment advice. Moreover, we wish to highlight the role that faulty information can play in misdirecting investors toward unproven and ideologically-driven opinions regarding the putative safety of certain instruments.

For instance, the incorporation of the simplistic efficient markets hypothesis into "educational" material will likely mislead vulnerable retail investors into believing that novel and illiquid markets (or even traditional equity markets) inevitably incorporate all available information and are not the product of manipulation or intervention.<sup>6</sup>

It requires a suspension of belief to regard education that is intended ultimately to encourage investment as an anodyne exercise in neutral instruction. For example, some investments in novel, highly engineered financial instruments are inherently unsafe. We urge the DoL to determine that "educational" material touting these risky instruments fall outside of the carve-out, as a matter of law.<sup>7</sup>

#### B. *Counterparty & Swap Transaction Carve Outs:*

We understand the impulse to create a fiduciary exemption for arms-length contracts involving counterparties and swap dealers. Under current market practice,

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<sup>4</sup> *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

<sup>5</sup> Even in 2007, before the full impact of the recent financial crisis, the New York Times recognized that "[m]any pension plans lack the analytical skills needed to evaluate [i]nvestments." Editorial, *Pensions and the Mortgage Mess*, N.Y. Times, Aug. 7, 2007, at A18.

<sup>6</sup> See, e.g., Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance*, 17 *The J. of Econ. Perspectives* 83-104 (2003).

<sup>7</sup> Critics may argue that such a limitation may impact the liquidity of esoteric, "innovative" financial products. However, it is critical to recognize that, at least in the retirement account arena, certain financial activities are so risky or conflicted that it would behoove the DoL to explicitly ban them or to take actions that would dramatically reduce trading in such activities.

purveyors of complex swaps must necessarily tout their products as valuable – otherwise one suspects that many plan fiduciaries would refrain from buying them given the calamitous performance of such products since 2008. However, we wish to emphasize to the DoL that the fundamental objective of the fiduciary rule is to protect investors, not the bottom line of profit-seeking banks. To understand why the counterparty and swap carve-out is flawed, it is useful to consider the fiduciary standards applicable to lawyers as a useful analog.

It is axiomatic that a lawyer owes a fiduciary duty to her client.<sup>8</sup> There is no relaxation of that standard, irrespective of the size or sophistication of the client. Moreover, a lawyer cannot represent a client if there is a significant risk that that representation will be materially limited by a personal interest of the lawyer.<sup>9</sup> So for example, if a lawyer sells title insurance, she may not do so to a client in a real estate transaction if there is a conflict of interest. **In sharp contrast, the Proposed Rule permits a retirement adviser to sell a financial product to its advisee provided that the advisee meets certain sophistication standards.** Both lawyers and retirement advisers render important advice that can have a grave impact on the financial position of the client. Why should the bar be set so much lower for financial advisers? The only plausible reason – because of the influence of the financial services lobby – is unsatisfactory.

We likewise caution against premising exemptions on an adviser's or fiduciary's intent or declarations regarding the independence of the parties. Given the abstruse and novel nature of instruments like security-based swaps,<sup>10</sup> independence alone is no substitute for the precautionary safeguards afforded by the fiduciary standard, the application of which would limit overwhelming risk-taking by retail investors (and the financial system *en masse*).

#### C. *Individual Account Plan Platform Providers & Related Assistance Carve Out*

Our concerns also extend to the carve-out for individual account plan platform providers and related assistance carve outs (although we recognize the independence of the parties in this arena). Disclosure and information requirements are inadequate safeguards as instruments are often so complicated that it is beyond the ken of plan beneficiaries and representatives to understand them. In addition, as we describe in more detail below, the rule should require that investment advisers clearly and prominently disclose when they are not acting in a fiduciary capacity.

#### D. *Valuation & Fairness Opinions Carve Out*

We object, in part, to the carve-out for valuations and fairness opinions for Employee Shared Ownership Plans and certain investment funds as well as valuation reports and regulatory disclosure statements. We recognize that the exclusion does not cover reports involving assets lacking a generally recognized market or serving as the basis upon which the plan makes distributions. However, instead of being the means by

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<sup>8</sup> See, e.g., *Cox v. Delmas*, 99 Cal. 104, 123 (1893).

<sup>9</sup> See Model Rules of Prof'l Conduct R. 1.7(a)(2) (2009).

<sup>10</sup> As we elaborate on below, these instruments have threatened to overwhelm the capabilities of investors and regulatory agencies alike.

which employees obtain control and sustainable value, ESOPs often function as simply another tool in the financial arsenal of companies focused solely on their stock market capitalization (to the exclusion of virtually any other financial or social value). At the very least, a requirement to advise employees of appraisal value would allow such employees to understand the value of their investments—and perhaps advocate for a fairer distribution of income and retirement investment.

In addition, investment experts point out the excessive risk of strategies that concentrate in company stock, sometimes with disastrous consequences for employees.<sup>11</sup> ESOPs are an area where the conflicts of interest are often largest. It is unwise to carve out such advice. In other areas, the DoL relies on fiduciary obligations to mitigate conflicts of interest and increase investor protections. It is prudent to do so for ESOPs as well. We recognize that this may well reduce the use of ESOPs but we do not believe that would necessarily be a bad outcome for employees.

The Proposed Rule’s Preamble asserts that “[i]n many cases the most important investment advice that an investor receives is advice as to how much it can or should pay for hard-to-value assets.” We could not disagree more. Retail investors should be steered *completely away* from hard-to-value assets rather than advised on how much to pay for them. Even if investors receives good advice on purchase price, there is no assurance that such advice would prove useful in the future when they might desire, or need, to dispose of hard-to-value assets. So, it is better if retail investors avoid such securities or rely on advisors that they hire themselves. There should be no delay in promulgating a rule regarding appraisals and valuations in the context of ESOPs.

*E. Employee of Plan Sponsors Carve Out:*

The exclusion for employees of plan sponsors appears reasonable so long as sponsors themselves continue to face fiduciary duties and/or other means of checking abuses of responsibility.

*F. Exemption for Broker-Dealers:*

The Agency’s decision to retain the broker-dealer exception under circumstances where no advice is provided raises some concerns.<sup>12</sup> We acknowledge that the text of Sections 3(21) and 403 of the Act limits the liability of broker-dealers when following the directions of plan fiduciaries, participants, and IRA holders as to participant-directed funds. In addition, the SEC may soon be issuing a new rule on fiduciary duties for broker-dealers pursuant to the Dodd-Frank Act. However, maintaining one clear source of enforcement authority under ERISA has advantages. As the studies that the DoL commissioned in preparing for issuance of this rule show, ordinary investors are typically unaware of the applicable standard of care or the source of legal authority and enforcement. Other agencies also may decline to enforce relatively small claims involving retail pension accounts, and so we encourage the DoL to refrain from “passing the buck” to another agency.

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<sup>11</sup> See, e.g., Mitchell, Olivia S. and Utkus, Stephen P., *Company Stock and Retirement Plan Diversification*, Pension Research Council Working Paper No. 2002-4, *available at* <http://ssrn.com/abstract=304461>. While, as that paper points out, it is possible to employ strategies to mitigate that risk, it is unclear that that is done in most ESOP plans.

<sup>12</sup> 29 C.F.R. 2510-3(21)(d) (proposed).

*G. Best Interest Contract Exemption:*

On its face, the Best Interest Contract Exemption (“BICE”) encapsulates a simple and common-sense rule: when it comes to public retirement accounts, any investment adviser should put the client’s interest first, ahead of his own.

While BICE ostensibly approximates the fiduciary standard, elevating the client’s interest above all, the BICE is actually inconsistent and unworkable. An adviser who puts the client’s interest above all must, *a fortiori*, be free of any conflicts of interest. But the BICE plainly permits a conflict of interest in allowing advisers to enjoy commissions and bonuses tied to investments (under certain circumstances). A conflict exists because a commission incentivizes the adviser to consider his own interest *in addition to* the client’s, instead of putting the client’s interest first.

For instance, in some cases, the best long-term advice that an investment adviser can give is that the investor should refrain from investing. However, under the BICE, the adviser has an incentive to churn the client’s account with the hope of turning a short-term profit despite market conditions that augur disaster in the future.

To consider another example, an investment adviser may be weighing two equally profitable investment options. The first involves a 5% commission payable by the client, while the second involves a 1% commission. Both the 1% and the 5% commission figures are “reasonable” in the industry. Since each option involves the same return (except for fees), an investment adviser could utilize the BICE to recommend the higher commission option, *even though it is not in the best interest of the plan beneficiary*.

In its current form, the BICE permits investment advisers to engage in self-dealing to the detriment of clients. The “best interest” of the client requires not just disclosing possible deficiencies in a recommended investment strategy but actively advising the client against *all strategies other than the very best one*.

By allowing investment advisers to have their cake and eat it too, the BICE dilutes the proposed fiduciary standard back to the old suitability standard. The Agency need not have expended considerable resources in proposing the instant regulation if its intention were a mere reaffirmation of the current standard. We exhort the Agency to eliminate the BICE and settle upon a simple fiduciary standard, the protestations of industry interest notwithstanding.

*H. The Inefficacy of Disclosure:*

The Agency inordinately relies on disclosure as a means to justify various exemptions contained in the rule.

First, disclosure has limited utility where the potential wrongdoer is the party that is given the responsibility of providing the relevant information to investors. If an investment adviser has engineered a swap deal with the express intention of taking advantage of its advisee, it will not meaningfully disclose that fact. Advisers will only willingly disclose meaningless or benign information.

Moreover, regulators in other areas have come to understand that disclosure can be useless in some cases, especially where the sheer volume of the disclosed material

militates against actual comprehension of risk.<sup>13</sup> Even where disclosed information is meaningful, the relevant bits of information may be buried in a sea of paper that would effectively pre-empt actual comprehension of risk by investors. For instance, in its investigation of Citigroup's Class V Funding III collateralized debt obligation ("CDO"), the SEC learned that Citigroup had disclosed to investors in its pitch book and offering circular that it had taken a short position in the underlying credit derivative.<sup>14</sup> The SEC nevertheless continued the investigation, which culminated in a \$285 million settlement.<sup>15</sup>

Moreover, disclosure is particularly ineffective in illiquid markets because these markets typically feature information asymmetries or pricing obscurities. As noted above, the Agency itself has recognized the proliferation of hard-to-value assets in investment accounts. Advisers dabbling in illiquid markets simply may not have enough information to disclose material conflicts-of-interest, even if they have the best of intentions.

Further, even if investment advisers were able to identify and disclose conflicts of interest as required by the Proposed Rule's various exemptions, plan beneficiaries or representatives may not be able to appreciate or digest such disclosures. The savviest of institutional investors may not have sufficient resources or access to information to verify the contents of disclosure documents, especially within the context of highly illiquid markets. The example of Long Term Capital Management will demonstrate that even sophisticated parties may not be aware of or fully appreciate the risks involved in their own activities.<sup>16</sup> Many investors simply presume that an adviser's recommendation is reliable, relying on the adviser's reputation as an information proxy.<sup>17</sup>

#### **IV. Scope of Fiduciary Rule and Coverage**

We, first, commend the language in the Proposed Rule that makes clear that a determination that a party is not a fiduciary does not prevent other enforcement actions or the application of the prohibited transaction rules and party-in-interest designation.<sup>18</sup> We recommend that the Agency issue a final rule that does not just apply existing fiduciary requirements but attends to the unique characteristics of the 401(k) and IRA environment. In particular, we call for the Agency to require, pursuant to the duty of loyalty, clear limits on and disclosure of fees and conflicts. The Agency should likewise mandate a duty of care standard that requires more than mere diversification and fund solvency.

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<sup>13</sup> See, e.g., Troy A. Paredes, Address at Twelfth Annual A. A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law, Fordham Law School (Oct. 27, 2011) (speech given in Securities and Exchange Commission Paredes's individual capacity).

<sup>14</sup> *Sec. & Exch. Comm'n v. Citigroup Global Markets Inc.*, SEC Litigation Release No. 22134 (Oct. 19, 2011).

<sup>15</sup> *Id.* The Southern District of New York later rejected the SEC's application to confirm this paltry settlement figure, because such a confirmation would turn the courts into "an agent of oppression." See *SEC v. Citigroup Global Markets Inc.*, Case No. 11 Civ. 7387, slip op. at 15 (S.D.N.Y. filed Nov. 28, 2011).

<sup>16</sup> See generally Roger Lowenstein, *When Genius Failed: The Rise and Fall of Long-Term Capital Management* (2001).

<sup>17</sup> See Andrew T. Tuch, *Conflicted Gatekeepers: The Volcker Rule and Goldman Sachs* 57 (Apr. 2011), available at [http://www.law.harvard.edu/programs/olin\\_center/fellows\\_papers/pdf/Tuch\\_37.pdf](http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Tuch_37.pdf).

<sup>18</sup> 29 CFR 1510-3(21)(c) (proposed).

Although we understand the Agency’s interest in applying a clear fiduciary standard that borrows from the long-standing principles of trust law, we recommend supplementary protections that address the unique condition of the 401(k) and IRA context, which include: limited assistance for individual investors, difficulty with enforcement, as well as complex and opaque relationships between industry participants.

The scope of fiduciary duties for investment advisors as to individually directed 401(k) and IRA accounts should parallel standards under ERISA, the Investment Advisor Act and the Dodd Frank Act so as to harmonize regulatory coverage. These requirements should transcend the existing FINRA suitability requirements in a way that not only facilitates enforcement but prevents known and tail risks.

*A. Duty of Loyalty:*

We recommend that the duty of loyalty require more than disclosure of fees and conflicts of interests but should also limit wasteful contracting or service arrangements. These concerns extend to the parameters of existing fee and compensation plans pursuant to the Best Interest Contract rule and modifications of existing PTEs. The complexity of the marketplace is likely to drive up prices while providing no clear benefit with regard to the nature of returns or the quality of services provided.<sup>19</sup> The Byzantine structure of the current marketplace provides choices that investors cannot fully evaluate. These complex and opaque choices may also inhibit effective enforcement of the fiduciary rule with regard to the actions of subcontractors.

In addition, disclosure of the cost of advice should include all compensation, direct and indirect, that an adviser may receive. The DoL regulations, finally, should require that advisers clearly and prominently disclose when they are not acting in a fiduciary capacity.

*B. Duty of Care:*

The duty of care should extend not only to diversification and general evaluation of fund solvency but also to consideration of the particular investment instrument at issue. The existing statutory and regulatory standard, we recognize, does include language regarding risk, diversification, liquidity, and projected investment return in light of funding objectives of the plan.<sup>20</sup> However, even this broad this language does not account for transformations in the investment environment for vehicles such as mutual funds, which have long been perceived as stable investments. As the Supreme Court has ruled with respect to other fiduciary duties under ERISA, fiduciary duties should encompass monitoring management decisions and investment strategy over time and not be limited to mere allocation and distribution decisions.<sup>21</sup> The nature of the sponsor, beneficiary, or IRA holder and its ability to weather a downturn are all important considerations.

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<sup>19</sup> Robert Hiltonsmith, *The Retirement Savings Drain - The Hidden Cost of 401(k)s*, White Paper, Demos Organization (2012).

<sup>20</sup> 29 U.S.C. s. 1104(a)(1)(B) (2012); 29 C.F.R. s. 2550.404a-1(b)(1) – (2) (2012).

<sup>21</sup> *Tibble v. Edison Int’l*, 575 U.S. \_\_\_\_ (2015) (remanding for determination of whether contours of fiduciary duty and the common law of trusts demonstrated a violation of continuing duty to monitor and remove imprudent investments); 29 C.F.R. s. 2509.75-8.

We also recommend as core investment considerations whether there exists a stable and liquid market for trading in the particular instrument, and the degree of leverage present in the product or strategy. Even in the absence of conflicts or improper fees, the financial advisor must evaluate whether the complexity of the 401(k) or IRA and relationships with contractors will limit returns for beneficiaries and IRA holders.

The investment advisor should also account for whether the nature of the investment plan or IRA (including assets and beneficiaries) makes more probable that the fund will not be able to redeem assets in the event of a catastrophic event. The Global Financial Crisis of 2008 and individual events such as the Enron collapse<sup>22</sup> provide strong evidence of the severe effects that such an event could have on retirement income.

## **V. Risks for Workers & Industrial Policy**

Investment plans cause uncertainty for ordinary investors in at least two ways. First, the duty of care must encompass the possibility that the investment or strategy will create a heightened probability of a specific event or global tail risk that will affect IRA holders' and beneficiaries' job security and hamper their ability to supplement retirement income. The last concern is especially heightened in the arena of employment-based retirement accounts (and ESOPs) where there may be a contradiction between heightened returns and the long-term health of the business and security of stakeholders such as employees.

But the problem pertains to the allocation of middle-income retail investors' income in instruments and industries that lead to an insecure environment not only in terms of systemic financial risk but also in terms of employment security and economic allocation. While this dynamic may not be intuitive, it is a fundamental problem with the current low-growth environment for retail investors. Ironically, the call for allowing investors to handle greater risks follows a decline in private defined benefit pensions and employer-directed funds and a concurrent trend toward unstable employment and insecure retirement funds.<sup>23</sup>

Commentators have criticized the investment of employees' pensions in high-return instruments and public companies that have eliminated jobs. Those investments contribute to a world of high-equity returns that are the result of eliminating productive parts of enterprises and workforces in order to maximize short-term returns. At the minimum, the Final Rule should protect the particular employees who risk losing their own jobs, particularly through poorly managed ESOP programs. The global problem is that by allowing for employees' assets to be directed toward those public companies whose rates of short-term returns are heightened without accounting for externality effects on industry and labor, investment policies help create a financialized version of the market economy in which productive assets are taken in order to produce little of

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<sup>22</sup> *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 284 F. Supp.2d 511, 555 (S.D. Tex. 2003) (setting forth numerous violations of fiduciary duties following actions that resulted in large-scale destruction of employee retirement wealth).

<sup>23</sup> DAVID WEIL, *THE FISSURED WORKPLACE*, *passim* (2014); David H. Webber, *The Use & Abuse of Labor's Capital*, 89 NYU Law Rev. 2106 (2014) (comparing the use of public pensions to requirements under ERISA) [SSRN-id2380661].

social value, while destroying the stability of employment and associated benefits such as retirement accounts.

Investment advisors, like other players in the financial services industry, generate an environment of growing systemic financial instability. As financial instruments and strategies continue to evolve, the potential exists for plan sponsors, plan beneficiaries, and IRA holders alike to be confronted with investment instruments and strategies that are almost entirely unfamiliar and present unknowable tail risks.

Of course, industry advocates will champion innovation in the marketplace in parallel with innovation in productive industries. Yet even to the degree that there is a legitimate basis for high-risk strategies and instruments involving ordinary beneficiaries, it owes to an environment where continuing financial and equity crises in Puerto Rico, Greece, and China are emblematic of heightened risks and are coextensive with lower and/or unpredictable returns. This contagion emerges, in part, from the environment of unchecked investment in highly-leveraged instruments such as Residential Mortgage Backed Securities that existed prior to the Financial Crisis of 2008. Allowing investment advisors to seek heightened returns for individuals without consideration of the systemic risks of their actions helps perpetuate these systemic factors and contradicts the policies behind the Dodd-Frank Act.<sup>24</sup>

Agencies such as the DoL are not impervious to a lack of foresight about novel financial sector risks. There often is no pertinent data or pattern of performance regarding novel financial strategies and “innovations” that can produce even an unreliable prediction of instrument performance or tail risk events.<sup>25</sup> The Agency should adopt this precautionary principle in determining how to safeguard the interests of 401(k) sponsors and beneficiaries and IRA holders, and also to help address systemic risk concerns that are more directly within the purview of the Federal Stability Oversight Council.

Ultimately, investment in high-risk instruments and strategies can intensify the possibility of employment loss and financial catastrophe. More generally, the practice can result in economic misallocation in financialized products and corporations with an emphasis on short-term returns. **A weak fiduciary rule, then, not only impoverishes investors but impairs the businesses, and ultimately, the economy on which workers are reliant for earnings.** It would be especially troubling if the DoL’s fiduciary rule facilitated the growth of these pernicious investment strategies despite their well-publicized failures.

The duty of care, therefore, must encompass an evaluation of the risks, leverage, and liquidity associated with a particular instrument or strategy. It must account for loss of returns or control in the event of complexity and reliance on multiple contractors to deliver investment advice. It must include an evaluation at all junctures, including in

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<sup>24</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, H.R. 4173 (2010)).

<sup>25</sup> See, e.g., Darryll Hendricks, Evaluation of Value-at-Risk Models Using Historical Data, Fed. Res. Bank of New York Economic Policy Review (April 1996) (noting incongruities between VaR modeling and actual conditions). VaR risk measurements often suffer from foundational failures, especially in light of changed conditions. See Taleb, Nassim Nicholas, Canetti, Elie R.D., Kinda, Tidiane, Loukoianova, Elena & Schmieder, Christian, A New Heuristic Measure of Fragility and Tail Risks: Application to Stress Testing (August 2012) IMF Working Paper No. 12/216, available at <http://ssrn.com/abstract=2156095>.

rollover and allocation decisions, of the vulnerability of the 401(k) plan or IRA holder to downturn and loss of employment as well as the availability of plan redemption.

## **VI. Conclusion**

In summary, we thank the Agency for taking an important step towards raising the standard of conduct applicable to retirement account advisers, and we encourage it to promulgate an undiluted Final Rule that vindicates the promise of the fiduciary standard. Anything less would put future retirees at risk.

Thank you.

Sincerely,

/s/

Occupy the SEC

Neil Taylor  
Josh Snodgrass  
Akshat Tewary  
et al.