AARP Real Possibilities

August 7, 2017

VIA *EBSA.FiduciaryRuleExamination@dol.gov*

Timothy D. Hauser
Deputy Assistant Secretary for Program Operations
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW,
Washington, DC 20210

Re: RIN 1210-AB82
Request for Information Regarding the Fiduciary Rule
and Related Prohibited Transaction Exemptions

Dear Mr. Hauser:

AARP appreciates the opportunity to respond to the Department of Labor's (the Department) Request For Information Regarding the Fiduciary Rule and Related Prohibited Transaction Exemptions. To better reflect changes in our retirement system, the 2016 Regulation updates the definition of who is a fiduciary as a result of providing investment advice for a fee to retirement investors. Indeed, two district courts stated that the 2016 Regulation was more consistent with ERISA's statutory definition of fiduciary than the 1975 Regulation. S*ee Chamber of Commerce of the United States v. Hugler,* 2017 U.S. Dist. LEXIS 17619, *38 (N.D. Tex. Feb. 8, 2017) ("the five-part test is the more difficult interpretation to reconcile with who is a fiduciary under ERISA."); *Nat'l Assn. for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1, 28 (D.D.C. Nov. 4, 2016) ("the new interpretation better comports with the text of the statute than the [old] rule"). According to the Investment Company Institute, over 82 million households are counting on employer-sponsored plans, Individual Retirement Accounts (IRAs), or both, for their retirement security. In order to better ensure that these families will have adequate income in retirement, investors need to know that the retirement advice provided by financial service professionals is in their sole interests.

AARP is the largest nonprofit, nonpartisan organization representing the interests of over 38 million Americans age 50 and older and their families. Nearly half of our members are employed full or part-time, with many of their employers providing retirement plans. A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. The shift from defined benefit plans to defined contribution plans has transferred significant responsibility to individuals for investment decisions that will directly impact the adequacy of the assets available to fund future retirement needs. AARP has enthusiastically supported the Fiduciary Rule as a necessary protection for participants when they make investment decisions concerning their retirement assets. Without this protection, it is difficult for an individual to plan for a secure and adequate retirement.

AARP members were actively engaged in voicing their support for this Rule during the open comment period in 2015. Close to 100,000 AARP members took over 200,000 actions in support of the Rule in 2015, including submitting close to 60,000 messages to the U.S. Department of Labor, and delivering over 26,000 petitions to the House Financial Services Committee. We are still communicating with our members now about the Department of Labor’s current open comment period on modifications to the Rule and further delay of its enforcement and expect that many of our members will write or call to support the Rule. AARP has also used its own channels to inform our members and the broader public about the benefits of the Rule, including multiple articles in AARP’s Bulletin, which is delivered to all 38 million members. We have worked in collaboration with organizations such as Yahoo Finance to produce educational videos regarding the Rule and its benefits. Finally, AARP is developing a tool that will walk investors through the questions they should ask a prospective or existing financial adviser, including whether the adviser operates under a fiduciary standard. We developed the app in collaboration with the North American Securities Administrators Association and anticipate launching the tool in the fall of 2017.

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A large number of the questions request only the viewpoint of, or information from, the regulated community as opposed to the participants and beneficiaries who would directly be impacted by, and benefit from, the Fiduciary Rule and related Prohibited Transaction Exemptions. Accordingly, AARP will respond to the questions in the RFI, as appropriate.

General Questions

2. What has the regulated community done to comply with the Rule and PTEs to date, particularly including the period since the June 9, 2017, applicability date? Are there market innovations that the Department should be aware of beyond those discussed herein that should be considered in making changes to the Rule?

The financial services industry generally agrees that investment advice should be provided in the best interests of the participant and retirement investor. Registered investment advisers and certified financial planners have for decades successfully provided fiduciary advice. Noting that the public demand for fiduciary advice has increased dramatically and that the market continues to move in the direction of providing fiduciary advice, in June 2017, the Certified Financial Planner Board of

Standards issued for public comment proposed revisions to its *Standards of Professional Conduct*, which sets forth the ethical standards for CFP® professionals. The draft revision broadens the application of the fiduciary standard, effectively requiring CFP® professionals to put a client's interest first at all times. The current *Standards* require CFP® professionals to act in a fiduciary capacity only when providing financial planning. The CFP® Board is expected to finalize its updated *Standards* later this year.

Public comment letters to the Department of Labor also demonstrate the overwhelming consensus on the best interest standard, *e.g.*, Transamerica Comment Letter 894 ("The Company has consistently indicated its support for a best interest standard, transparency and treating customers fairly"); SIFMA Comment Letter 506 ("The industry … shares that goal" "to ensure financial services providers are looking out for their customer's best interest"); Plan Sponsor Council of America Comment Letter 614 ("[W]e believe our retirement system will be greatly strengthened by ensuring that investment advice is provided in the recipient's best interest consistent with those fiduciary standards and that any financial conflicts are disclosed."); American Council of Life Insurers Comment Letter 621 ("We share the Department's interest in seeing that plan sponsors, plan participants and Individual Retirement Accounts (IRA) owners receive advice that is in their best interest."); American Bankers Association Comment Letter 622 ("We agree with the Department that retirement service providers, when acting in their capacity as fiduciaries, should act in the best interest of customers and that such customers deserve to be protected from financial abuse."); Insured Retirement Institute Comment Letter 626 ("Financial professionals should be held to a best interest standard when recommending investments to retirement investors."); Business Roundtable Comment Letter 645 ("Financial professionals should be required to act in the best interests of employee benefit plan participants when providing investment advice to a retirement plan or its participants."); Wells Fargo Comment Letter 647 ("[W]e remain supportive today of a "best interest" standard of care for clients.").

There should be no surprise about this consensus since these statutory standards have been in place since the Employee Retirement Income Security Act (ERISA) was enacted in 1974. Indeed, treating those who provide investment advice for a fee as a fiduciary is consistent with both the statute and the common law of trusts upon which ERISA was based. Significantly, although there have been attempts to weaken the Rule requiring those who provide investment advice for a fee to be treated as a fiduciary, Congress has never agreed to weaken the standard adopted over 40 years ago to protect and preserve employees' hard-earned retirement savings.

Investment firms have made business decisions on how to structure their customer relationships, including whether to make use of the Prohibited Transaction Exemptions for certain products or particular fee arrangements. The decision of each firm may be different depending on an analysis of its business model and its client base. By way of example, three of the largest defined-contribution plan service providers are reported to have chosen three distinctly different compliance strategies,[1] showing the flexibility of the Rule and related Exemptions that are provided to businesses.

While some disruption within the retirement services industry can be expected after updating a 40-year old regulation to make it relevant to the current retirement marketplace, the disruption has overall been positive for retirement investors. The disruption has resulted in lower fees, advice in the best interest of the saver or retiree, and minimized conflicts in advice provided to individuals. Many investment firms and their advisers have also taken steps to meet the requirements of the regulation and already have incurred one-time, up-front compliance costs. Importantly, we have not seen fees increase by those companies that have significantly complied with the Rule. Obviously, for those firms and advisers that attempted in good faith to comply with the Rule, significant future changes will negatively impact their businesses and call into question whether they should incur additional expense to comply with any final regulation as modified.

Americans saving for retirement have the majority of their savings in defined contribution plans and IRAs. Given the nearly $8 trillion in assets in IRAs and the almost $5 trillion in 401(k) plans, there is neither evidence— nor any reason to believe — that financial service providers will abandon this lucrative market.[2] Thus, to the extent there are disruptions caused by the final regulation, retirement savers stand to benefit as the various players in the financial services industry adjust to maintain their competitive edge. AARP has every confidence that the financial services industry and the retirement advice market will continue to develop innovative new products and systems to help hard working Americans save for retirement, while minimizing conflicts of interest.

[1] Greg Iacurci, *Fidelity, Empower and T. Rowe take three different approaches to the DOL fiduciary rule*, INVESTMENT NEWS (Mar. 7, 2017), http://www.investmentnews.com/article/20170307/FREE/170309941/fidelity-empower-and-t-rowe-take-three-different-approaches-to-the?AID=%2F20170307%2FFREE%2F170309941.

[2] ICI Research Report, Defined Contribution Plan Participants’ Activities, First Three Quarters of 2016 at 2 (Feb. 2017), https://ici.org/pdf/ppr_16_rec_survey_q3.pdf.

3. Do the Rule and PTEs appropriately balance the interests of consumers in receiving broad-based investment advice while protecting them from conflicts of interest? Do they effectively allow Advisers to provide a wide range of products that can meet each investor's particular needs?

The regulatory imbalance between the duties of brokers and investment advisers and less sophisticated retirement savers has persisted for many years, even as evidence demonstrating that brokers have transformed themselves from sales persons into advisers has grown. Many brokers today call themselves “financial advisers,” offer services that clearly are advisory in nature, and market themselves based on the advice offered. For example, one firm advertises that it “proudly strive[s] to embrace [its] own fiduciary responsibilities” and that its “highest value is to ‘always put the client first,’”[3] even though its Form ADV brochure (a regulatory filing that the SEC requires to be given to clients after a transaction is completed) demonstrates otherwise, noting that “[d]oing business with our affiliates could involve conflicts of interest if, for example, we were to use affiliated products and services when those products and services may not be in our clients’ best interests.”[4] As a result of such misleading statements, the average investor cannot distinguish between brokers and advisers and does not recognize that their “financial adviser” operates under a lower legal standard than that to which a registered investment adviser is held.

Nor is it surprising that investors expect that those who advertise themselves as a trusted adviser will provide financial advice in the best interest of the investor. Federal regulations have not kept pace with changes in business practices, and broker-dealers and investment advisers continue to be subject to different legal standards when they offer advisory services. According to the Commission’s 2011 Study on Investment Advisers and Broker-Dealers, as of the end of 2009, FINRA-registered broker-dealers held over 109 million retail and institutional accounts and approximately 18 percent of FINRA-registered broker-dealers also are registered as investment advisers with the Commission or a state.[5]

Embedded in the question is the premise that the more choices participants and beneficiaries have, the better off they are. However, study after study has shown that

[3] Letter from Robert Reynolds, President and CEO of Putnam Investments, to U.S. Dep’t of Labor (July 20, 2015), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00077.pdf.

[4] Putnam Advisory Company, LLC, SEC Form ADV Part 2A at 25 (Mar. 30, 2016), http://www.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=375046. (Putnam Investments wholly owns Putnam Advisory Company through various subsidiaries.).

[5] S.E.C, *Study on Investment Advisers and Broker-Dealers* (Jan. 11, 2011).

too much choice hinders decision-making. *E.g*., Richard Thaler and Cass Sunstein *Nudge: Improving Decisions About Health, Wealth and Happiness (*Yale University Press, 2008) (a study of company retirement plans found that when a default option automatically selected an investment portfolio, saving employees the chore of picking their own mix of assets, participation shot up from 9% to 34%);T. Langer & C.R. Fox, *Bias in allocation among risk and uncertainty: partition-dependence, unit dependence, and procedure dependence* (2005), https://www.google.com/url?sa=t&rct=j&q=&esrc =s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKEwio6ZG-qt7UAhVDcT4KHX UZBlwQFggqMAE&url=http%3A%2F%2Ffox-lab.org%2Fwp-content%2Fuploads%2F 2016%2F11%2FLangerFoxWP05-1.pdf&usg=AFQjCNH5anhxHCF2eVHFYcw ErYKcbVJnZw; Julie Agnew & Lisa Szykman, A*sset Allocation and Information Overload: The Influence of Information Display, Asset Choice and Investor Experience 10*, Center for Retirement Research at Boston College (2004), http://crr.bc.edu/working-papers/asset-allocation-and-information-overload-the-influence-of-information-display-asset-choice-and-investor-experience/ (lower information individuals experience statistically greater feelings of overload with more choices and invest less in the default option); Sheena S. Iyengar, Wei Jiang & Gur Huberman, *How Much Choice is Too Much?: Contributions to 401(k) Retirement Plans* Pension Research Council, The Wharton School, (PRC WP 2003-10), http://www.nagdca.org/dnn/Portals/45/2015 Annual/\16.%20How%20much%20choice%20is%20too%20much%20choice.pdf (participation in 401(k) plans is higher in plans offering a handful of funds, as compared to plans offering ten or more options); *cf.* Sheena S. Iyengar & Mark R. Lepper, *When Choice is Demotivating: Can One Desire Too Much of a Good Thing*?, 79 J. OF PERSONALITY AND SOC. PSYCHOLOGY 995-1006 (2000), http://psy2.ucsd.edu/ ~nchristenfeld/DoG_Readings_files/Class%209%20-%20Iyengar%202000.pdf (finding that excessive choice can produce choice paralysis and reduce people's satisfaction with their decisions). AARP believes that the range of investment products and services available to meet the needs of retirement investors is more than adequate.

Moreover, there is nothing in the Fiduciary Rule or the Exemptions preventing advisers from providing general investment education such as asset allocation, charts and graphs.

Under the Rule and related Exemptions, Americans will still be able to access a variety of retirement savings offerings. There is no prohibition in the Rule against any type of retirement investment product. The Rule does not require investment firms to abandon products, but instead allows the investment marketplace to evolve and innovate to provide investments and products that answer the needs of individuals who now shoulder greater responsibility for their retirement security, while at the same time providing protections for their hard-earned retirement monies. Indeed, the market is responding already to the public demand for fewer conflicts of interest, greater transparency, and lower fees. The recent development of new investments with differentiated fees such as clean shares and T shares by leading investment firms demonstrate this point. (See AARP's Response to Question 7.) Conversely, as individual firms respond to market signals, they may discontinue offerings that do not meet client demands. The choice to develop or discontinue an offering is up to an individual adviser, broker or firm. Because ERISA does not have an authorized or legal list of permissible investments, the Rule is consistent with Congress' design of ERISA's broad fiduciary rules.

Ensuring all professionals who offer investment advice to retail investors are subject to a fiduciary standard is needed to ensure a level and transparent market for investors seeking advice. Investors deserve a regulatory system that is designed to promote the best interests of the investor and imposes comparable standards on investment professionals who are performing essentially the same function as financial advisers. Research has found investors typically rely on the recommendations they receive from brokers and investment advisers alike. The trust most investors place in financial professionals is encouraged by industry marketing, leaving investors vulnerable not only to fraud but also to those who would take advantage of that trust in order to profit at their expense. Investors who place their trust in salespeople who market services as financial advisers can end up paying excessively high costs for higher risk or underperforming investments that only satisfy a suitability standard, but not a fiduciary standard. That is money most middle-income investors cannot afford to lose.

Realistically, there is too much money involved in the retirement market for financial services providers to leave the market. They will adjust and have begun to do so to maintain their competitive edge. AARP believes that the financial services and insurance industries will continue to design new products, develop pragmatic solutions to the issues raised in the Rule and Exemptions, and energetically compete for the dollars that Americans will save and invest for retirement. And, in order to keep those dollars, the industries will need to ensure that this money grows so savers and investors will have an adequate income in retirement.

4. During the transition period from June 9, 2017, through January 1, 2018, Financial Institutions and Advisers who wish to utilize the BIC Exemption must adhere to the Impartial Conduct Standards only. Most of the questions in this RFI are intended to solicit comments on the additional exemption conditions that are currently scheduled to become applicable on January 1, 2018, such as the contract requirement for IRAs. To what extent do the incremental costs of the additional exemption conditions exceed the associated benefits and what are those costs and benefits? Are there better alternative approaches? What are the additional costs and benefits associated with such alternative approaches?

AARP commends the Department for working with the financial services and insurance industries from the beginning of this project. After the initial proposed regulation in 2010, the Department re-proposed the Rule attempting to incorporate comments and provide answers to concerns from industry. The Department provided a one-year compliance period and then extended it to January 2018. The Department has provided the financial services and insurance industries with sufficient time to bring their policies and procedures into compliance.

Two district courts have made it clear that there is no going back to a regulatory standard that provides less protection than the statute itself. S*ee Chamber of Commerce of the United States v. Hugler,* 2017 U.S. Dist. LEXIS 17619, *38 (N.D. Tex. Feb. 8, 2017) ("the five-part test is the more difficult interpretation to reconcile with who is a fiduciary under ERISA."); *Nat'l Assn. for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1, 28 (D.D.C. Nov. 4, 2016) ("the new interpretation better comports with the text of the statute than the [old] rule"). Studies show that participants, beneficiaries and investors obtain better returns when the investment advice they receive is not conflicted.[6] Accordingly, conflicted advice is harmful to participants, beneficiaries and investors. The costs to advisers do not outweigh the benefits to the participants, beneficiaries and investors.

Contract Requirement in BIC and Principal Transaction Exemptions

The contract requirement in the BIC Exemption and Principal Transactions Exemption and resulting exposure to litigation creates an added motivation for Financial Institutions and Advisers to oversee and adhere to basic fiduciary standards, and provides that IRA owners have an additional means to enforce those protections. Throughout the fiduciary rulemaking, however, commenters have been divided on the contract requirement, with many expressing concern about potential negative implications for investor costs and access to advice. As noted above, the Department is interested in the possibility of regulatory changes that could alter or eliminate contractual and warranty requirements.

5. What is the likely impact on Advisers' and firms' compliance incentives if the Department eliminated or substantially altered the contract requirement for IRAs? What should be changed? Does compliance with the Impartial Conduct Standards need to be otherwise incentivized in the absence of the contract requirement and, if so, how?

The likely impact of elimination or substantial alteration of the contract and warranty requirements for IRAs is that conflicts of interest will rage without any check, as they have done for years. We think that the contract and warranty requirements in the current Rule should remain. Firms providing any advice concerning monies to be invested in IRAs should have written policies and procedures in place that are designed to assure compliance with the conditions of the exemption. In particular, the

[6] Bergstresser, Daniel, John Chalmers, and Peter Tufano. 2009. "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry." *The Review of Financial Studies* 22(10): 4129-4156.
Del Guercio, Diane, and Jonathan Reuter. 2014. "Mutual Fund Performance and the Incentive to Generate Alpha." *The Journal of Finance* 69: 1673-1704.

acknowledgement that the adviser is a fiduciary should be maintained. Such acknowledgements and requirements are not novel in Prohibited Transaction Class Exemptions. For example, these requirements are substantially similar to the requirements in the Qualified Professional Asset Manager (QPAM) Exemption, PTE 84-14, as amended in 2010, as well as the In-House Asset Manager (INHAM) Exemption, PTE 96-23. Not only should investment firms provide compliance training for their advisers, they must promote and instill a culture of compliance through adoption of appropriate policies and procedures and supervisory oversight. Finally, if there are no contract and warranties, investors have no method to ensure compliance with the impartial conduct standards. There must be an alternative to fill in that gap, and a contract with warranties is that alternative.

AARP believes that the required documentation of investment recommendations is a win-win for both the adviser and the investor. Writing out the rationale for recommendations compels the adviser to make sure that s/he has taken all of the investor’s necessary information into account. The investor’s approval of the recommendations protects the adviser and prevents misunderstandings.

Not only should advisers adopt practices and written policies and procedures along with training programs to comply with the impartial conduct standards, but they should also monitor the implementation of those practices and the compliance of their advisers with the impartial conduct standards. Lastly, the advisory firms should take appropriate action when the impartial conduct standards are violated and modify their policies and procedures when necessary to improve overall compliance.

6. What is the likely impact on Advisers' and firms' compliance incentives if the Department eliminated or substantially altered the warranty requirements? What should be changed? Does compliance with the Impartial Conduct Standards need to be otherwise incentivized in the absence of the warranty requirement and, if so, how?

See AARP’s Response to Question 5.

Alternative Streamlined Exemption

As noted above, the Department is also interested in receiving additional input from the public on possible additional and more streamlined exemption approaches that would better address marketplace innovations that may mitigate or even eliminate some kinds of potential advisory conflicts otherwise associated with recommendations of affected financial products innovations.

7. Would mutual fund clean shares allow distributing Financial Institutions to develop policies and procedures that avoid compensation incentives to recommend one mutual fund over another? If not, why? What legal or practical impediments do Financial Institutions face in adding clean shares to their product offerings? How long is it *anticipated to take for mutual fund providers to develop clean shares and for distributing Financial Institutions to offer them, including the time required to develop policies and procedures that take clean shares into account? What are the costs associated with developing and distributing clean shares? Have Financial Institutions encountered any operational difficulties with respect to the distribution of clean shares to the extent they are available? Do commenters anticipate that some mutual fund providers will proceed with T-share offerings instead of, or in addition to, clean shares? If so, why?*

The Fiduciary Rule and its Exemptions allow the investment marketplace to evolve and innovate to provide investments and products that answer the needs of individuals who now shoulder greater responsibility for their retirement security as well as provide protection for their hard-earned retirement monies. Indeed, the market is responding already to the public demand for fewer conflicts of interest, greater transparency, and lower fees. The recent development of new investments with differentiated fees such as clean shares and T shares by leading investment firms demonstrate that the marketplace is fully capable of fashioning new products to mitigate conflicts and to lower the differential compensation that creates incentives to favor sales that increase compensation to the adviser. These shares could allow the broker's compensation for fund recommendations to be negotiated separately with the investor, not unlike commissions on sales of stocks and ETFs. In addition, advisers and their firms can charge additional fees for services, such as recordkeeping fees, but the investor would be specifically informed about these fees.

AARP believes that these innovations could not only result in more transparency and fewer conflicts of interest, but also significantly lower costs. Quite simply, these innovations lower the pressure on advisers to recommend investments from which they will make more in indirect fees. A Morningstar analysis finds that investors could save at least 50 basis points in returns compared with current offerings, plus another 20 basis points because advisers will have the incentive to recommend a fund in the investor's best interest. Aron Szapiro, Paul Ellenbogen, *Early Evidence on the Department of Labor Conflict of Interest,* MORNINGSTAR (Apr. 2017), http://corporate1.morningstar.com/ResearchLibrary/article/802119/early-evidence-on-the-department-of-labor-conflict-of-interest-rule/. A savings of an additional seventy basis points would result in a significant increase in an investor's account value. U.S. Gov. Accountability Office, *GAO-07-21, Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* 7 (Nov. 2006).[7]

[7] The GAO has estimated that $20,000 in a 401(k) account that had a one-percentage point higher fee for 20 years would result in an over 17 percent reduction in the account balance, a loss of over $10,000. We estimate that over a 30-year period, the account would be about 25 percent less. Even a difference of only half a percentage point — 50 basis points — would reduce the value of the account by 13 percent over 30 years. Conflicted advice resulting in higher fees and expenses can have a huge impact on retirement income security levels.

While these are promising innovations, the Department must look closely at the structure of these new investments to determine if they address all conflicts of interest or whether they merely mitigate them. For example, fees such as sub-transfer fees frequently are embedded in the recordkeeping and other fees. These fees must be disclosed and either charged directly to the client or absorbed by the asset managers. The bottom line is that the Department must ensure that undisclosed fees are not tacked onto the clean shares.

If these new investments mitigate but do not eliminate conflicts, then if the Department issues a new Exemption, the Department should ensure that it can make the necessary administrative findings under section 408(a) of ERISA. In order to do so, the Department should address, at a minimum, the following questions:

- How will these new types of investments be documented;
- How will these new types of investments be sold;
- Will these types of investments result in new conflicts of interest among different categories of investment products offered by the same adviser;
- How will any remaining conflicts of interest be addressed by the firms and advisers;
- What oversight will be provided and by whom;
- Who will be responsible for the development and implementation of policies and procedures and for fixing problems that are uncovered during supervisory review; and
- What is the appropriate mechanism for the Department to use to enforce compliance?

AARP notes that the longer the Department delays in finalizing the Fiduciary Rule and its Exemptions, the more likely it becomes that financial firms will cease development on these types of innovations. This is important because conflict free products that have less costs will benefit retirement investors.

We note that the marketplace has responded to the Rule and the Exemptions by developing services such as benchmarking and training for investment and insurance firms, advisers, plans and IRA providers that are readily available at reasonable cost. Indeed, there are now significant new opportunities in the rollover space to ensure compliance with the Rule and Exemptions.

8. How would advisers be compensated for selling fee-based annuities? Would all of the compensation come directly from the customer or would there also be payments from the insurance company? What regulatory filings are necessary for such annuities? Would payments vary depending on the characteristics of the annuity? How long is it anticipated to take for an insurance company to develop and offer a fee-based annuity? How would payments be structured? Would fee-based annuities differ from commission-

based annuities in any way other than the compensation structure? How would the fees charged on these products compare to the fees charged on existing annuity products? Are there any other recent developments in the design, marketing, or distribution of annuities that could facilitate compliance with the Impartial Conduct Standards?

The insurance industry has responded to the Rule with new classes of annuities, which — compared to the offerings pre-Rule — have lower cost, short (or) no surrender periods, lower surrender charges, and better investment options. These changes are all beneficial to the consumer. However, the Department will still need to ensure that certain questions are answered. For example, what are the fees inside the annuity? If there is an annuity wrap account, upon what assets are the fees calculated and how is their value determined?

9. Clean shares, T-shares, and fee-based annuities are all examples of market innovations that may mitigate or even eliminate some kinds of potential advisory conflicts otherwise associated with recommendations of affected financial products. These innovations might also increase transparency of advisory and other fees to retirement investors. Are there other innovations that hold similar potential to mitigate conflicts and increase transparency for consumers? Do these or other innovations create an opportunity for a more streamlined exemption? To what extent would the innovations address the same conflicts of interest as the Department's original rulemaking?

Financial professionals have long used automated investment tools to help their customers build and manage their investment portfolios. These tools are now directly available to customers. And, some of these tools have been combined into what are now being called robo-advisors.

Robo-advisors usually use passive investing, which empirical evidence has found for a large majority of consumers to be a successful strategy. Robo-advisors can provide advice at low cost and in a tax-efficient manner. Portfolios can be monitored and rebalanced easily. Robo-advisors can be transparent, easy to use, and systematic. Finally, robo-advisors have the ability to provide broad access to investors, including small account holders. Jonathan Walter Lam, Senior Essay: *Robo-Advisors: A Portfolio Management Perspective,* Yale University (Apr. 4, 2016), http://economics.yale.edu/sites/default/files/files/Undergraduate/Nominated%20Senior%20Essays/2015-16/Jonathan_Lam_Senior%20Essay%20Revised.pdf.

While robo-advisors provide considerable promise, they too can include various biases and conflicts. For example, an algorithm can be biased to suggest that an investor purchase more securities than a similarly situated investor would normally purchase in reliance on non-biased advice. And, to state the obvious, when using any program, the outputs are only as good as the inputs. For the right investors, robo-advisors can be effective alternatives to in-person advisors, but we know that they are not for everyone. Robo-advisors are just another example of the ingenuity and innovation of which we believe the financial services and insurance industries are capable. If the Department intends to issue a Class Exemption for robo-advisers, it will need to delve more deeply into how these robo-advisers are structured and engineered.

AARP recognizes that robo-advisors are still in their relative infancy; however, ongoing advancements in this technology will continue to create new and additional access points to non-conflicted advice for savers. We believe that non-conflicted advice, in any form, is superior to conflicted traditional advice. Many investors who do not receive any non-conflicted advice would be better off than they were before. Finally, we believe that American ingenuity and entrepreneurial drive will make these robo-advisors more sophisticated over time. Thus, robo-advisers have the promise of developing into a more effective advice alternative, particularly in the small account market.[8]

10. Could the Department base a streamlined exemption on a model set of policies and procedures, including policies and procedures suggested by firms to the Department? Are there ways to structure such a streamlined exemption that would encourage firms to provide input regarding the design of such a model set of policies and procedures? How likely would individual firms be to submit model policies and procedures suggestions to the Department? How could the Department ensure compliance with approved model policies and procedures?

Even with policies and procedures, there must be some objective requirements in the Exemptions to reduce conflicts. Without such objective requirements, the Department could not make its necessary findings under section 408(a) of ERISA.

Incorporation of Securities Regulation of Fiduciary Investment Advice

11. If the Securities and Exchange Commission or other regulators were to adopt updated standards of conduct applicable to the provision of investment advice to retail investors, could a streamlined exemption or other change be developed for advisers that comply with or are subject to those standards? To what extent does the existing regulatory regime for IRAs by the Securities and Exchange Commission, self-regulatory bodies (SROs) or other regulators provide consumer protections that could be incorporated into the Department's exemptions or that could serve as a basis for additional relief from the prohibited transaction rules?

AARP encourages the Security and Exchange Commission (SEC) to implement uniform standards of conduct applicable to both investment advisers and broker dealers, consistent with the existing fiduciary standard enacted by the Department. Such rulemaking must place the consumer's best interest in its forefront. Currently,

[8] If the advice is working correctly, investors should eventually over time move out of the small account balance category.

many broker-dealers are not subject to a fiduciary duty when they provide personalized investment advice to their clients. Instead, they are required only to make suitable investment recommendations. There is no obligation under the suitability rule to have reasonable grounds to believe a recommendation is in the best interest of the customer. AARP believes that securities professionals who offer investment advice to retail investors should be subject to a fiduciary standard in order to guarantee a fair and transparent system for those seeking advice.

Adoption of a uniform standard that would apply to both broker-dealers and investment advisers when providing personalized investment advice to retail customers, as contemplated by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), is of critical importance and long overdue. The fiduciary standard should be based on the core principle that when providing personalized investment advice to retail customers, a financial adviser must always act in the best interests of those customers regardless of their marketing strategy, business model, or registration status. Comparable standards on investment professionals, who are performing essentially the same function as financial advisers, should be consistent across agencies.

Principal Transactions

The Principal Transaction Exemption provides relief only for certain investments (certain debt securities, CDs and unit investment trusts) to be sold by Advisers and Financial Institutions to plans and IRAs in principal transactions and riskless principal transactions, while the BIC Exemption provides additional relief for parties to engage in riskless principal transactions without any restrictions on the types of investments involved.

1*2. Are there ways in which the Principal Transactions Exemption could be revised or expanded to better serve investor interests and provide market flexibility? If so, how?*

Disclosure Requirements

13. Are there ways to simplify the BIC Exemption disclosures or to focus the investor's attention on a few key issues, subject to more complete disclosure upon request? For example, would it be helpful for the Department to develop a simple up-front model disclosure that alerts the retirement investor to the fiduciary nature of the relationship, compensation structure, and potential sources of conflicts of interest, and invites the investor to obtain additional information from a designated source at the firm? The Department would welcome the submission of any model disclosures that could serve this purpose.

Recent behavioral science studies have shown that disclosures are ineffective because they do not decrease conflicts and instead make the investor more likely to follow biased advice. Sunita Sah, Gray Matter, *The Paradox of Disclosure*, NEW YORK TIMES, July 8, 2016, https://www.nytimes.com/2016/07/10/opinion/sunday/the-paradox-of-disclosure.html?_r=0; Sunita Sah and George Loewenstein, *Nothing to Declare: Mandatory and Voluntary Disclosure Leads Advisors to Avoid Conflicts of Interest*, 25(2) PSYCHOL. SCI. 575 –584 (2014); *cf*. Sunita Sah, Angela Fagerlin, and Peter Ubel, *Effect of physician disclosure of specialty bias on patient trust and treatment choice,* http://www.pnas.org/content/113/27/7465.full.pdf.

Moreover, AARP believes that investors should not be forced to request disclosures. We know that investors will more likely than not refrain from making such requests.[9] AARP would be in favor of an executive summary of the most important points (not unlike a summary of benefits or summary prospectus) so that investors' understanding of the investment process including costs and fees would be increased.

Contributions to Plans or IRAs

14. Should recommendations to make or increase contributions to a plan or IRA be expressly excluded from the definition of investment advice? Should there be an amendment to the Rule or streamlined exemption devoted to communications regarding contributions? If so, what conditions should apply to such an amendment or exemption?

Recommendations to make or increase contributions to a plan or IRA do not need to be expressly excluded from the definition of investment advice. The current definition provides the necessary guidance for these recommendations. If there is a recommendation to make or increase contributions to a plan or IRA but there is no fee, the recommendation is not covered under the definition. This provides adequate protection for those plan sponsors that are trying to help their employees save for a dignified retirement. For example, if an employer provides information concerning the benefits of making such contributions and a recommendation to do so, the employer would not be covered under the definition because the employer is not receiving a fee. Conversely, if a broker or insurance agent makes such a recommendation and receives a fee for the investments made, that would be covered under the definition. Quite simply, it depends on the facts surrounding the recommendation and whether a fee, indirect or direct, is involved. To the extent that the regulated community is concerned about this issue, the Department can issue a FAQ or other clarifying guidance.

Bank Deposits and Similar Investments

Some commenters have raised questions about the compliance burden under the Rule and PTEs on small community banks that currently do not exercise any fiduciary

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[9] AARP notes that post-transaction disclosures are ineffective because investors are frequently surprised when they realize that they have not purchased the type of investment they thought they had.

functions for customers when their employees discuss opening IRAs or investing their IRAs in bank deposit products such as CDs. Some have also raised questions about the need for a special rule for cash sweep services. Still others have said that health savings accounts (HSAs) merit a special exclusion or streamlined exemption because they tend to be invested in shorter-term deposit products to pay qualifying health expenses.

15. Should there be an amendment to the Rule or streamlined exemption for particular classes of investment transactions involving bank deposit products and HSAs? If so, what conditions should apply, and should the conditions differ from the BIC Exemption?

Grandfathering

Section VII of the BIC Exemption provides a grandfathering provision to facilitate ongoing advice with respect to investments that predated the Rule, and to enable advisers to continue to receive compensation for those investments. Some commenters thought this provision could be expanded in ways that would minimize potential disruptions associated with the transition to a fiduciary standard and facilitate ongoing advice for the benefit of investors.

16. To what extent are firms and advisers relying on the existing grandfather provision? How has the provision affected the availability of advice to investors? Are there changes to the provision that would enhance its ability to minimize undue disruption and facilitate valuable advice?

PTE 84-24

17. If the Department provided an exemption for insurance intermediaries to serve as Financial Institutions under the BIC Exemption, would this facilitate advice regarding all types of annuities? Would it facilitate advice to expand the scope of PTE 84-24 to cover all types of annuities after the end of the transition period on January 1, 2018? What are the relative advantages and disadvantages of these two exemption approaches (i.e., expanding the definition of Financial Institution or expanding the types of annuities covered under PTE 84-24)? To what extent would the ongoing availability of PTE 84-24 for specified annuity products, such as fixed indexed annuities, give these products a competitive advantage vis-à-vis other products covered only by the BIC Exemption, such as mutual fund shares?

AARP supports the Department's final amendment to PTE 84-24 as it limits IRA and Plan transactions to annuity contracts that are defined as a "Fixed Rate Annuity Contract" and excludes relief for IRA purchases of mutual fund shares. We also agreed that PTE 84-24 should remain available for investment advice fiduciaries to receive commissions for IRA purchases of insurance and annuity contracts that are not securities. Any annuity contract that can fluctuate in value should be in the BICE. Any annuity contract which offers the investor the security of fixed payments for the life of the contract should covered by PTE 84-24.

AARP submits that the definition of the term “Financial Institution” should be retained because it protects the investor. AARP supports the Department’s decision to limit relief under the proposal to Financial Institutions and Advisers that are subject to regulatory oversight and supervision by a state or federal agency of the Financial Institutions.

Communications With Independent Fiduciaries With Financial Expertise

The Fiduciary Rule contains a specific exclusion for communications with independent fiduciaries with financial expertise. Specifically, a party's communications with an independent fiduciary of a plan or IRA in an arm's length transaction are excepted from the Rule if certain disclosure requirements are met and the party reasonably believes that the independent fiduciary of the plan or IRA is a bank, insurance carrier, or registered broker-dealer or investment adviser, or any other independent fiduciary who manages or controls at least $50 million. Some commenters have requested that the Department expand the scope of the exclusion.

18. To the extent changes would be helpful, what are the changes and what are the issues best addressed by changes to the Rule or by providing additional relief through a prohibited transaction exemption?

Regarding the exemption that the American Retirement Association has proposed, our reading of that proposal is that fees would only have to be level within each type of investment category (e.g., mutual fund shares), not across investment alternatives. For example, if a plan offers Exchange Traded Funds (ETFs) and Collective Investment Trusts (CITs), the fees could vary between CIT and ETF investments, but not within each category. AARP believes that the proposal, as we understand it, does not make sense since it continues to create conflicts for the investment adviser. Obviously, a safer approach would be level fees across all investments offered to the plan by the adviser. Our reading of the proposal is that it addresses some of the conflicts within investment classes, but not all of the obvious conflicts among investment alternatives. Although DOL Advisory Opinion 97-15A is still good law, it is limited only to investments in mutual funds by a discretionary bank trustee and removes the conflict by crediting third party mutual fund fees back to the plan. This Advisory Opinion and its safeguards would not work in a plan portfolio consisting of potentially different asset classes.

This proposal is particularly troubling because it would mainly affect 401(k) plan rollovers to IRAs. As the Boomers retire, they are encouraged to move their money from protected ERISA plans to IRAs. These IRA investors are more vulnerable to the negative impact of conflicted advice because the amount of assets available for rollover are large, many older investors do not have strong financial literacy skills, and they are making significant and often one-time decisions to move their retirement savings from more protected employer based plans into significantly less protected IRAs.[10] The Department found that advice from conflicted investment advisers could cost these retirees between 12 to 24 percent in lost retirement savings over thirty years.[11] If AARP's reading of ARA's proposal is correct, we believe that, as currently proposed, there are insufficient and inadequate safeguards for participants and beneficiaries so that the Department could not make its necessary findings under section 408(a) of ERISA.

We thank the Department for its consideration of our comments. As we review the issues raised in other comments, AARP may respond with further comments of our own. If you have any questions, please feel free to contact me or Jasmine Vasquez of our Government Affairs office at 202-434-3711.

Sincerely,

David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs

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[10] *Id*. at 59-60.

[11] U.S. Dep't of Labor, *Fiduciary Investment Advice: Regulatory Impact Analysis* 3-4 (2015).