

April 17, 2017

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

**Re: RIN 1210-AB79 – Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128 (the “DOL Rules” or “Rules”<sup>1</sup>)**

To Whom it May Concern:

The questions posed by the President to the Department of Labor (“the Department”) in his April 3, 2017, memorandum<sup>2</sup> and the subsequent questions posed by the Department to the public in its proposal to extend the application date of the DOL Rules<sup>3</sup> can be condensed into one question: Are the DOL Rules the best path forward to increase the frequency with which high-quality, unconflicted investment advice is offered to retirement investors?

National Planning Holdings, Inc. (“NPH”) asserts that the answer to this question is an emphatic, “No.” There are far better ways to increase the frequency with which retirement investors receive high quality, unconflicted investment advice than the harmful path proposed by the Department. The DOL Rules will:

- Significantly reduce access to advice for millions of low and middle wealth Americans at a time when the need for advice, guidance, and support has never been greater because of the retirement crisis and savings gap our country is facing;

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<sup>1</sup> DOL Rules, 81 Fed. Reg. 20,946, 21,001 (April 8, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-07924.pdf>.

<sup>2</sup> On February 3, 2017, President Trump issued a memorandum that set forth several goals of the current Administration that relate to retirement planning. The President also instructed the Department to undertake a comprehensive review of the expected impact of the DOL Rules, which are currently scheduled to go into effect on June 9, 2017. Presidential Memorandum on Fiduciary Duty Rule for the Secretary of Labor (Feb. 3, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule>.

<sup>3</sup> DOL Request for Comment, 82 Fed. Reg. 12,319, 12,326 (March 2, 2017) (to be codified at C.F.R. pt. 2510), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-03-02/pdf/FR-2017-03-02.pdf>. Following the receipt of approximately 193,000 comment and petition letters, the Department granted the delay. DOL Delay, 82 Fed. Reg. 16903, (April 7, 2017) (to be codified at C.F.R. pt. 2510), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-04-07/pdf/2017-06914.pdf>.

- Increase costs and reduce product and provider choice for those consumers who are able to access advice; and
- Tilt the playing field in favor of the lowest cost products at the expense of all other considerations and lead millions of Americans into their retirement without protection against market, sequence of return, and longevity risk at a time when there is widespread, bipartisan consensus that access to, and utilization of, guaranteed income products, which offer these important benefits, should be promoted, not discouraged.

As for the required economic analysis, the DOL Rules will so radically remake the market for retail investment advice that no one can objectively predict their economic impact with a reasonable degree of economic precision. Thus, the most meaningful components of the economic analysis of the Rules are the starting assumptions. Together with our affiliate, Jackson National Life Insurance Company (“Jackson”)<sup>4</sup> we urge the Department not to disregard and to weigh more heavily than it has to date the predictable negative outcomes of the Rules described in this letter when ascribing probabilities to the mountain of projections and figures that have been put before it. When these negative outcomes are given due consideration, it is clear that the DOL Rules will result in significant net costs and harm to consumers and the businesses that provide them with retirement services and products.

### **The DOL Rules Radically Transform the Market for Retail Investment Advice.**

It is important to establish at the outset that the DOL Rules will radically transform the market for retail investment advice. This is true even if the analysis is limited to the effects of those portions of the DOL Rules that are currently scheduled to go into effect on June 9, 2017. On that date, the DOL Rules:

- Substantially broaden the circumstances when an individual who offers advice to retirement investors (e.g., investors who possess qualified assets in a 401(k), IRA, or other tax-advantaged account) will become subject to the Employee Retirement Security Income Act (“ERISA”) fiduciary standard and its corresponding restrictions and risks, thereby making approximately 70% of the retail advice market ERISA fiduciaries overnight; and
- Establish one, and only one, lawful way for newly designated fiduciaries to receive compensation for offering advice regarding general securities or insurance products: comply with the Impartial Conduct Standards defined in the new rules, which raise the standard of care to the highest in existence and trump existing rules and regulations issued by the Securities Exchange Commission, (“SEC”), Financial Industry Regulatory Authority (“FINRA”), and the states.

Considered alone, the changes effective June 9 will significantly impact the ability to retail firms, like the NPH firms, to provide services to clients; however, under the recently announced delay of

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<sup>4</sup> This comment letter is modeled after Jackson’s comment letter, but does raise issues that are unique to the retail broker/dealer model.

the application date of the Rules<sup>5</sup>, the regulatory framework described above remains in effect only until January 1, 2018. At that point in time, all of the provisions of the Rules (including all of the provisions of the Best Interest Contract Exemption (“BICE”) and amended Prohibited Transaction Exemption 84-24) are currently scheduled to go into effect. The harm done by the Rules will be even greater when full compliance is required.

### Broadening the Definition of “Fiduciary” Transforms the Regulatory Framework That Has Governed Retail Advice for Decades.

The DOL Rules represent one of the most significant and expansive regulatory restructurings of the investment advice market since the Great Depression. The new rules radically expand the application of the fiduciary standards under ERISA by revising the Department’s 40-year-old test for determining when a person giving advice about retirement savings is deemed a “fiduciary.”<sup>6</sup> The prior test<sup>7</sup> applied principally to interactions between representatives of retirement plans and advisers. The revised test extends ERISA’s reach to virtually every interaction between individual retirement savers and advisers. Before the new DOL Rules (i) the SEC and FINRA served as the primary regulators of most investment adviser representatives (fee-based) and broker-dealer representatives (commission-based), and (ii) the states served as the primary regulator of individuals and firms that offer advice about insurance products that are not securities. The Department and ERISA were rarely applicable to the retail advice market.

That all changes on June 9th, when the Department and ERISA will take center stage, make ERISA fiduciaries of approximately 70% of the retail advice industry, trump long-standing FINRA, SEC, and state rules and regulations, and add an additional rule book that rarely applied before to an already extensive web of regulation and consumer protections.

Incredibly, in the delay notice, the Department skips right past this most significant development. The Department states, “[T]he Fiduciary Rule [i.e., changing the definition of “fiduciary”] ... [is] among the least controversial aspects of the rulemaking project ....” That is an incredible statement given the impact of fiduciary status under ERISA and the DOL Rules. In countless comment letters, testimony and other forums, critics of the DOL Rules have clearly objected to the Department remaking an entire industry in a way that will harm small- and mid-size investors without coordinating with FINRA, the SEC, or the states.

### The Impartial Conduct Standards Are Transformative.

Even though the Department’s recent delay of the Rules’ applicability date suspends the application of much of the BICE until January 1, 2018, retirement advisers will still be required to comply with the Impartial Conduct Standards defined in the Rules beginning on June 9, 2017. This is no small feat, as the Impartial Conduct Standards substantially raise the standard of care for broker-dealer representatives. There are four important provisions under the Impartial Conduct Standards:

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<sup>5</sup> 82 Fed. Reg. 16902 et seq. (April 7, 2017)

<sup>6</sup> Regulations Relating to Labor, 29 C.F.R. 2510.3-21 (2016).

<sup>7</sup> Regulations Relating to Labor, 29 C.F.R. § 2510.3-21(c) (1981)(current version at 29 CFR 2510.3-21 (2016)).

1. Best Interest Standard – requires that all advice reflect the care, skill, and diligence under the circumstances then prevailing that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor.
2. Without Regard to Financial or Other Interests – requires that all advice be given without regard to the financial or other interests of the retirement adviser and any affiliated financial institution. This represents a big change from existing FINRA and SEC standards. Potential conflicts of interest may no longer be sufficiently mitigated through full disclosure and informed consent. Rather, advisers are likely to conclude that they must re-structure their business to mitigate the risk that the Department, Internal Revenue Service (IRS), or a private or class action litigant will later allege that certain of the adviser’s operational processes, governance structures, affiliations, or compensation arrangements had the tendency to cause something less than completely unconflicted advice to be given at the point of sale. If this can be proved, then the adviser will have engaged in prohibited transactions and will be subject to the severe penalties that may result, including civil and criminal penalties, excise tax penalties, restitution, disgorgement of profits, and other relief deemed equitable by the courts.<sup>8</sup>
3. Reasonable Compensation – requires that the compensation for IRA accounts is consistent with the guidance under ERISA Section 408(b)(2) and IRS Rule 4975(d)(2), which require that services arrangements involving plans and IRAs result in no more than reasonable compensation. This is an objective standard that requires reasonableness to be based on all the facts and circumstances and market comparisons. It is not a defined safe harbor within which risk can be entirely mitigated.<sup>9</sup> This, too, substantially raises risks for broker-dealer and investment adviser representatives and insurance agents, who formerly priced their

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<sup>8</sup> Section 4975 of the Internal Revenue Code imposes a nondeductible excise tax on the amount involved for each prohibited transaction that occurs in a year. [See IRC 275\(a\)\(6\)](#). The disqualified person who participated in the prohibited transaction pays the excise tax. [See 4975\(a\)](#). ERISA Sections 502(i), (l), (c)(2), (c)(7) authorize civil penalties. See also: <https://www.law.cornell.edu/cfr/text/29/part-2560>. See also <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement/erisa> See [ERISA §409\(a\)](#) (liability for breach of fiduciary duty to make restitution to the plan of losses resulting from the breach, disgorge profits obtained by the fiduciary through breach of duty and subject to other equitable or remedial relief deemed appropriate by the courts; [ERISA § 502\(l\)](#) (authorizing penalties for fiduciaries who breach a fiduciary responsibility equal to 20 % of the applicable recovery amount of any settlement agreement); [Internal Revenue Code § 4975\(a\)](#) (imposing a nondeductible 15 % excise tax for each prohibited transaction occurring in a year to be paid by the disqualified person); [IRC § 4975\(b\)](#) (imposing a 100 % second tier excise tax on a prohibited transaction that is not corrected during the taxable period).

<sup>9</sup>In the commentary for the DOL Rules, the Department noted, “The reasonableness of the fees depends on the particular facts and circumstances at the time of the recommendation. Several factors inform whether compensation is reasonable including, inter alia, the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the investor receives.” DOL Rules, 81 Fed. Reg. 20946, 21030 available at <http://webapps.dol.gov/federalregister/PdfDisplay.aspx?DocId=28807>.

services in a highly competitive environment at the cost the market would bear, after making full and fair disclosure to, and obtaining the informed consent of, the client.

4. No Material Misleading Statements – requires that material representations to clients are not misleading. There is no change here. Misrepresentations have always been forbidden under all regulatory frameworks.

This fundamental change in standards comes at a perilous time.

#### The Onset of a Retirement Savings Crisis is Not the Time for Radical Regulatory Experiments.

Our country faces a retirement crisis. For the first time in our country's modern history, retiring Americans are predominantly dependent on their savings and social security to provide them with a steady stream of guaranteed income until their death ... and they are not prepared.<sup>10</sup> Forty-one percent of US working households age 55 to 64 have no retirement savings; 55% of households age 55 to 64 have less than \$25,000 in retirement savings.<sup>11</sup> Only 23% of baby boomers believe that their savings will last them through retirement, and that belief is optimistic in the estimation of our affiliate Jackson and others who have studied the situation.<sup>12</sup>

Researchers have concluded that current retirement planning efforts are inadequate and that over half of American households do not have savings sufficient for retirement.<sup>13</sup> The collective retirement savings gap among working households age 25-64 is estimated to be between \$6.8 to \$14 trillion.<sup>14</sup> Surveys estimate that 50-75% of Americans are not on track to meet key savings benchmarks.<sup>15</sup>

One of the best policy responses to address this crisis is to make personal advice and guaranteed income products more, not less, accessible. Recent studies indicate that the experience and stewardship offered by a financial adviser can enhance investor returns between 1.8% and 3.0%

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<sup>10</sup> In the 1980s, more than half of retiring private-sector workers were covered by a defined benefit plan. Today, only about 4% of retiring private-sector workers are covered solely by such a plan and only 14% by a combination of a defined benefit and defined contribution plans. *CNNMoney* Cable News Network, *Just How Common Are Defined Benefit Plans?*, [http://money.cnn.com/retirement/guide/pensions\\_basics.moneymag/index7.htm](http://money.cnn.com/retirement/guide/pensions_basics.moneymag/index7.htm) (last visited April 11, 2017).

<sup>11</sup> U.S. Government Accountability Office, "Most Households Approaching Retirement Have Low Savings." (May 2015), available at <http://www.gao.gov/products/GAO-15-419>. See also, Elyssa Kirkham, *1 in 3 Americans Have \$0 Saved for Retirement*, *GOBANKINGRATES.COM*, March 16, 2016, <https://www.gobankingrates.com/retirement/1-3-americans-0-saved-retirement/>.

<sup>12</sup> Press Release, Insured Retirement Institute, *Baby Boomers' Challenging Retirement Math* (April 3, 2017), available at <http://irionline.org/newsroom/newsroom-detail-view/baby-boomers-challenging-retirement-math>.

<sup>13</sup> Alicia H. Munnell, Wenliang Hou, and Anthony Webb, *NRRI Update Shows Half Still Falling Short* 14-20 (Center for Retirement Research at Boston College 1, 9 (Dec. 2014) (fifty-two percent of Americans are at risk of not having enough income in retirement), available at [http://crr.bc.edu/wp-content/uploads/2014/12/IB\\_14-20-508.pdf](http://crr.bc.edu/wp-content/uploads/2014/12/IB_14-20-508.pdf).

<sup>14</sup> Nari Rhee, 2013 (June), *The Retirement Crisis: It is Worse Than We Think?* National Institute on Retirement Security, June 2013 at 15.

<sup>15</sup> If measured solely on retirement assets, 92% of working households do not meet retirement asset targets. Even under broader definition of assets, most households will still not have sufficient savings for retirement. Ninety percent of households fall short based on retirement account balances and estimated defined benefit pension assets combined, 84 % fall short based on total financial assets, and 65 % fall short based on net worth. *Id.* at 1; See also Kirkham, *supra* note 11., <<https://www.gobankingrates.com/retirement/1-3-americans-0-saved-retirement/>>.

annually.<sup>16</sup> A little more than five years ago, the Department itself estimated that access to financial advice reduced the cost of investor “mistakes” by \$15 billion per year ... and that increasing access to financial advice would enable investors to save billions more.<sup>17</sup> Research has also clearly shown that having a retirement plan improves both the amount saved and consumer confidence.<sup>18</sup> Consumers benefit from financial planning, behavioral coaching, and guidance that personal investment advice provides.

Yet, the DOL Rules will make it more difficult for consumers to access advice, make advice more costly for consumers when it is available, and limit product options, especially guaranteed income products, when consumers need them most.

### **The DOL Rules Will Reduce Access to Advice.**

By any measure, the DOL Rules strongly discourage commission-based arrangements by requiring full compliance with the BICE as the only lawful way to maintain commission-based arrangements. The BICE is a formidable form of discouragement. It is exceedingly complex, and virtually every aspect of a financial institution must be reviewed and altered to comply with the BICE, including training, forms, disclosures, technology, compensation, operations, marketing, legal, compliance, and governance.<sup>19</sup> The cost and complexity of implementation has been significantly aggravated by the short time frame for compliance.

Not surprisingly, some financial institutions have indicated that they will no longer allow new brokerage IRA accounts and will shut down all commission based sales.<sup>20</sup> For example, one of the largest financial institutions in the country sent the following notice to its clients:

[B]eginning April 10, 2017 [the date the DOL Rules were initially scheduled to become applicable], [we] will no longer offer new advised brokerage IRA accounts. We plan to encourage our retirement clients to talk with their advisor about whether to move their brokerage IRA accounts to our Investment Advisory Program if they

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<sup>16</sup> ISECTORS, LLC REPORT, FINANCIAL ADVISORS ADD VALUE 1.8% -3.3% ANNUALLY (2014), <http://isectors.com/wp-content/uploads/2015/03/2014.06.30-Financial-Advisor-Value-FINAL.pdf>. See also RYAN RICH, COLLEEN M. JACONETTI, FRANCIS M. KINNIRY JR., DONALD G. BENNYHOFF, AND YAN ZILBERING, PUTTING A VALUE ON YOUR VALUE: QUANTIFYING VANGUARD ADVISOR’S ALPHA IN CANADA (2015), <https://www.vanguardcanada.ca/documents/value-on-your-value-tlr.pdf>.

<sup>17</sup> Investment Advice —Participants and Beneficiaries, 76 Fed. Reg. 66136, 66152 (Oct. 25, 2011) (to be codified at C.F.R. pt. 2550).

<sup>18</sup> Survey, Lisa Greenwald, Craig Copeland, and Jack VanDerhei *The 2017 Retirement Confidence Survey: Many Workers Lack Retirement Confidence and Feel Stressed About Retirement Preparations*, Employee Benefit Research Institute No. 431 (March 21, 2017), available at [https://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_431\\_RCS.21Mar17.pdf](https://www.ebri.org/pdf/briefspdf/EBRI_IB_431_RCS.21Mar17.pdf)

<sup>19</sup> Amidst the struggle to prepare for the implementation of more than 1,000 pages of new regulation, the Department has issued two sets of guidance (in October 2016 and January 2017) that address some questions but create others.

<sup>20</sup> Greg Iacurci and Christine Idzelis, *Broker-dealers Split on Commissions in Wake of DOL Fiduciary Rule* INVESTMENT NEWS, Oct. 30, 2016, available at <http://www.investmentnews.com/article/20161030/FREE/161029902/broker-dealers-split-on-commissions-in-wake-of-dol-fiduciary-rule> See also Megan Leonhardt, *Why Edward Jones Won't Let Investors Buy Funds, ETFs in IRAs*, TIME MONEY Aug. 22, 2016, available at <http://time.com/money/4459130/edward-jones-bans-funds-etfs-in-iras>.



would like to continue to receive investment advice. Legacy retirement assets – those in a ... IRA brokerage account before April 10, 2017 – can remain in that account, and will continue to have the benefit of our investment recommendations to hold or sell after April 10, 2017; however, under the new DoL rule, beginning April 10, 2017, retirement clients won't be able to add to legacy assets, or have the benefit of our investment advice about new purchases in their IRA brokerage accounts.

By significantly reducing, if not eliminating, commission-based arrangements, the DOL Rules will reduce access to personal advice for millions of low and middle wealth Americans.

Our ultimate parent company, Prudential plc, has first-hand experience with the adverse consequences of comparable regulation adopted in the United Kingdom (“UK”). When the UK enacted rules to eliminate commission-based payment arrangements, they found that the rules had real and significant adverse effects on retirement savers, particularly those with lower income. The rules increased the costs and reduced the accessibility of personalized investment advice. The UK Financial Services Authority (predecessor to the current Financial Conduct Authority (“FCA”)) launched the Retail Distribution Review (“RDR”) in 2006 which led to a number of rules that came into effect at the end of 2012. These rules were designed to make the retail investment market work better for consumers. A key provision of these rules was the elimination of commission payments from product providers to advisers and platforms (i.e., third-party payments).

The result of the RDR reforms has been a 25% reduction in the number of FCA registered advisers providing financial advice to retail clients of moderate means during the period leading up to and following the effective date of the new rules.<sup>21</sup> This reduction has resulted in an “advice gap” as advisers withdraw from serving small accounts that are no longer profitable for the adviser to serve. The advice gap means that many small account investors are now unable to get the financial advice they need. In 2015, the FCA conducted a Financial Advice Market Review (the “Review”) to assess whether the advice market in the UK was working following the RDR changes.<sup>22</sup> In the final report of the Review, published in March 2016, the FCA noted that while the changes did impact conflicts of interest, it created a situation where “advice is expensive and is not always cost effective for consumers, particularly those seeking help in relation to smaller amounts of money or with simpler needs.”<sup>23</sup>

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<sup>21</sup> Barclays, “*Asset Management/Life Insurance: UK Savings Conference 2015: What We Learnt. Working Paper*,” 9 (June 9, 2015), available at

<https://live.barcap.com/PRC/servlets/dv.search?contentPubID=FC2145798&bclink=decode>. See also, <http://www.apfa.net/documents/publications/APFA-report-the-advice-market-post-RDR-June-2014.pdf>.

<sup>22</sup> HM TREASURY FINANCIAL CONDUCT AUTHORITY, FINAL REPORT, FINANCIAL ADVICE MARKET REVIEW (MARCH 2016), available at <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>.

<sup>23</sup> *Id.* at 5. The report references a survey conducted in 2016 on behalf of the Association of Professional Financial Advisers in which 62% of advisers said that they had turned away potential clients in the last 12 months. The primary reason is that it was not economical to serve customers with lower amounts to invest. *Id.* at 6.

The Review has forced political and regulatory leaders in the United Kingdom to consider the advice gap as a serious issue that requires a solution.<sup>24</sup> The FCA identified advice as a priority in its 2016/2017 Business Plan.<sup>25</sup> The Department entirely and inappropriately dismissed the significant cost to consumers from the reduction in access to advice that will predictably result from the DOL Rules, concluding in its regulatory impact analysis, “the UK’s experience lends support of the Department’s conclusion that its reforms . . . are unlikely to result in a significant diminution of advice.”<sup>26</sup>

### **The DOL Rules Will Increase Costs and Reduce Product and Provider Choice for Consumers.**

The DOL Rules have direct and indirect impact on retirement clients due to the addition of another layer of complex regulation to a market that is already heavily regulated, requiring the collection and disclosure of reams of new information, raise the standard of care to the highest standard in existence, and significantly increase litigation and regulatory risk. These requirements will directly impact clients to the extent that products and services are curtailed, and will indirectly impact clients through additional costs.

In implementing the requirements of the Impartial Conduct Standard, the NPH firms and similar retail firms will significantly alter their models through –

- Preemptively reducing the range and number of products that are offered in response to the DOL Rules. Products and product features are no longer being offered to consumers for a variety of reasons, including the desire to simplify product menus in order to reduce the additional costs and risks of providing continued fiduciary oversight of product providers. For example, our range of offered mutual funds and variable annuities will be reduced to attempt to mitigate risk of operations under the BICE. We think the narrowing of options is bad for consumers and the overall vibrancy and resilience of the market for retirement products.
- Mutual fund pricing remains in flux and ultimately will cause confusion and uncertainty on June 9 and thereafter. As noted in the 60 day delay, there is significant industry discussion relative to the most appropriate share class for mutual fund sales under the BICE. While many investment companies had moved towards offering T Shares, there is now momentum towards clean shares. The DOL cites this as support for the 60 day delay, but fails to recognize that neither T Shares nor clean shares will be fully operational by June 9, leaving retail firms in a position where they may simply discontinue offering commission-based mutual funds. NPH does not agree with the DOL’s conclusion that clean shares are “the preferred long term

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<sup>24</sup> Naomi Rovnick , and Emma Dunkley, *FCA Proposes Reforms to Close ‘Advice Gap’* FINANCIAL TIMES, Mar. 14, 2016, available at <https://www.ft.com/content/4324f4dc-e9c8-11e5-888e-2eadd5fbc4a4>.

<sup>25</sup> FINANCIAL CONDUCT AUTHORITY, BUSINESS PLAN 2016/2017, available at <https://www.fca.org.uk/publication/corporate/business-plan-2016-17.pdf> .

<sup>26</sup> See DEPARTMENT OF LABOR ANALYSIS, REGULATING ADVICE MARKETS, DEFINITION OF THE TERM “FIDUCIARY” CONFLICTS OF INTEREST - RETIREMENT INVESTMENT ADVICE - REGULATORY IMPACT ANALYSIS FOR FINAL RULE AND EXEMPTIONS, §2.10, at 78 (2016), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>.



solution”<sup>27</sup>. The open front end compensation structure will leave firms open to claims that compensation was not reasonable, and also by its structure does not provide continuing trail revenue to assist firms and advisers to service clients, creating further incentives to actively switch clients between funds. The BICE ultimately destroys the current share class structure which was developed upon the premise that no single share class is suitable for all clients, and instead provides limitations that make it unlikely that firms will continue the current share class structure for IRA account. Simply stated there is no good option available for retail firms and their clients for commission-based mutual funds as of June 9 or thereafter, and even with full implementation of either clean shares or T shares many clients will be disadvantaged compared to current share class options.

- There continues to be significant unanswered questions relative to the impact of the BICE on existing mutual fund and annuity positions. While Section VII of the BICE (“Grandfathering”) provides some limited protection for retail firms, it leaves unanswered significant questions relative to the ability of retail firms to deal with a broad range of potential operational impacts including identification of systematic investments, accepting new clients with existing investments or compensation options not allowed by the firm after June 9, and other concerns as set forth in more detail below. These impacts will cause firms to either refuse to service the clients with these assets, or refuse to accept or advise on the non-approved assets.

Beyond the direct impact on clients cited above, the indirect impact on clients will be significant due to impact on retail firms. Retail firms are looking at significant costs of compliance and unquantifiable costs of litigation.

The cost to comply with the Rules is staggering. A report by Goldman Sachs estimates that initial compliance costs for the financial services industry will be more than \$13 billion with on-going annual costs of more than \$7 billion.<sup>28</sup> The cost of implementation is especially burdensome for those financial institutions who choose to rely on the BICE.

The DOL Rules will also unleash a torrent of spurious and destructive class action lawsuits, which will greatly increase the costs and risks of operating a business offering investment advice. Indeed, the DOL Rules were specifically designed to be enforced primarily through private and class action litigation.<sup>29</sup> The new DOL Rules reflect the Department’s view that today, “social change and legal change and financial change” are best achieved through “regulation” and

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<sup>27</sup> See 82 Fed. Reg. 16902, 16911.

<sup>28</sup> Paul Katzeff, *DOL Fiduciary Rule Impact Seen In Tens Of Billions Of Dollars*, INVESTOR'S BUSINESS DAILY, Apr. 18, 2016, available at <http://www.investors.com/etfs-and-funds/retirement/dol-fiduciary-rule-impact-on-industry-seen-in-tens-of-billions/>.

<sup>29</sup> Under the BICE, financial institutions must enter into new contracts with investors that include broad representations and warranties to comply with certain IRS regulations. These mandated contracts and their provisions thereby enable private investors to enforce IRS rules and regulations in the form of a state law claim for breach of contract. Additionally, firms are prohibited from requiring clients to waive their right to participate in class actions.

secondarily through “litigation.”<sup>30</sup> Not surprisingly, just as the trustees and advisers to qualified retirement plans have been subject to a torrent of institutionalized class action lawsuits alleging violations of ERISA, so too will retirement advisers and financial institutions offering advice to retail investors, once they become subject to the identical ERISA rule set. Whenever sufficient dollar amounts are at issue, plaintiffs’ class action lawyers will have an incentive to (and therefore will) second guess every judgment made by a financial institution in its effort to comply with the Rules, including whether they offered too many products, not enough products, the wrong kind of products, products that cost more than other products, products the financial institutions allegedly should have known would not perform as well as other products, and on and on and on.

Class litigants and their counsel will displace experienced government personnel in deciding which cases should be pursued. Rather than choosing cases that best serve the public interest and the government’s goal of compliance with the law, plaintiffs’ counsel motivated to earn large contingent fees will determine enforcement priorities and strategies while thousands of plaintiffs receive small recoveries from financial firms that are forced to settle to avoid larger potentially business killing verdicts. Equally troubling, state court judges from every county and town across the country will interpret the incredibly complex DOL Rules in conflicting ways without sufficient understanding of the issues.

A recent estimate of the long term cost of class actions relating to the DOL Rules puts the *annual* cost in the \$70 million to \$150 million range.<sup>31</sup> The same analysis concluded that “the cost of class action settlements alone could decrease the operating margin on the advised, commission-based IRA assets” by as much as 36%.<sup>32</sup>

It is axiomatic that most of these additional costs related to compliance, insurance, and litigation defense will be passed on to consumers, and as the cost to provide advice increases, financial institutions will be less willing to offer services to low and middle wealth consumers.

All of these increased costs, burdens, and streamlining will lead to industry consolidation, further reducing consumer choice and ruining many businesses. It is difficult to conceive how small- and mid-size businesses offering investment advice will be able to bear the costs and risks of the DOL Rules and continue to offer competitive pricing to consumers. We expect to see a significant reduction in the size of the industry and consolidation of those businesses that are left standing over the next 5 to 10 years. Worryingly, over 90% of the industry affected by the DOL Rules are “small businesses” according to Small Business Administration definitional standards.<sup>33</sup> The

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<sup>30</sup> Memorandum of Plaintiff at 23, *United States Chamber of Commerce v. Thomas Perez, Sec’y of Labor and the United States Dep’t. of Labor*, 3:16-cv-1476-M, p 23 July 18, 2016 (D.Texas) (quoting Borzi Highlights Changes to ERISA as She, Other Speakers Look Back at Law’s 40 Years, Bloomberg BNA, 41 BPR 1929 (2014)), available at <http://www.chamberlitigation.com/sites/default/files/cases/files/16161616/Reply%20Memo%20in%20Support%20of%20MSJ%20--%20Chamber%20of%20Commerce%20v.%20Perez%20%28USDC%20-%20Northern%20District%20of%20Texas%29.pdf>.

<sup>31</sup> Michael Wong, *Costs of Fiduciary Rule Underestimated*, MORNINGSTAR, Feb. 9, 2017, available at <http://news.morningstar.com/articlenet/article.aspx?id=793268>.

<sup>32</sup> *Id.*

<sup>33</sup> See DEPARTMENT OF LABOR ANALYSIS, *supra* note 29, §6.2, at 254.

owners and employees of these businesses are also consumers attempting to save and plan for retirement.

In the Regulatory Impact Analysis published in support of the DOL Rules, the Department recognized that it was possible that some small service providers would find that the increased costs of compliance with the Rules would outweigh the benefit of continuing to act as an adviser in the ERISA plan or IRA markets. However, the Department stated that,

The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because some firms will fill the void and provide services to the ERISA plan and IRA market. It is also possible that the economic impact of the rule on small entities would not be as significant as it would be for large entities, because anecdotal evidence indicates that small entities do not have as many business arrangements that give rise to conflicts of interest. Therefore, they would not be confronted with the same costs to restructure transactions that would be faced by large entities.<sup>34</sup>

This analysis significantly underestimates that impact on investor access and completely fails to consider the costs to the small firms that currently provide financial advice. While the smaller business may not have the same number of customers, the process and procedures requirements, as well as the litigation exposure, are as proportionately burdensome as they are to larger firms. The Department does not include in its cost/benefit analysis the costs associated with the closure of these small businesses as they are forced to exit the business and the impact on their employees.

One of the principal flaws with the new DOL Rules is that they make virtually anyone offering a “suggestion” about investments to a retirement investor a fiduciary. As discussed above, the increased costs and risks of providing a fiduciary level of service will result in many low and middle wealth investors losing access to financial advice – either because industry participants will not offer services to them, or the costs of the fiduciary service will exceed the perceived value to many investors. Many retirement savers are now and will continue to be best served with a lower-cost, non-fiduciary level of service, which still offers the significant consumer protections developed by the SEC, FINRA, and the states over decades. Many of these investors are not looking for on going investment advice but for example, might be seeking to purchase a product in an arms length transaction, fully understanding that they are not receiving fiduciary level services, or wish to ask basic question about rollovers or transfers.

Individual investors seeking advice, as well as advisers and financial institutions offering such advice, should have the option of establishing either a fiduciary or a non-fiduciary relationship. Jackson believes consumers should have their choice among three options (which would presumably offer three different price points commensurate with the levels of service and protection provided):

- Unsolicited business – where no “recommendation” is made to the “do-it-yourself” consumer, the current standards for the execution of unsolicited orders should apply

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<sup>34</sup> Id. at 258.

- Dealer and agents – where recommendations are made by a representative of a broker or dealer (operating in a non-fiduciary capacity), the existing suitability standards should apply. These standards should also be extended to cover non-fiduciary sales of insurance products.
- Fiduciaries – where an adviser offers fiduciary services, the adviser should be subject to the highest standard, which should apply uniformly to sales of securities and insurance, regardless of whether the source of funds is qualified or non-qualified.

Advisers and financial institutions offering advice, products, and/or services would need to clearly and plainly declare the capacity in which they are acting (i.e. fiduciary or non-fiduciary) before any interaction takes place. Thereafter, the adviser's conduct must remain consistent with the standards associated with the chosen capacity. This is a far less expensive, intrusive, and complex solution that will enhance investor protection while preserving consumer choice and diversity in the market for advice.<sup>35</sup>

### **The DOL Rules Will Reduce Access To, and Utilization Of, Guaranteed Income Products.**

Most problematically, the DOL Rules will nudge and shape investor and adviser behavior in a way that propagates the misuse and overuse of the lower cost products available at the expense of all other considerations and lead to the underuse or abandonment of guaranteed income products. Since the new rules were published, there has been a 30% drop in the market for guaranteed lifetime income products ... and the new rules are not even applicable yet. There is unanimity in retirement policy circles that guaranteed lifetime income products are an essential part of the solution to the retirement crisis for millions of Americans. The DOL Rules undermine efforts to increase annuitization of retirement savings. This will have a critical impact on NPH's clients and potential clients who need access to guaranteed lifetime income products. These concerns are set forth in more detail in Jackson's comment letter which is also being filed today.

### **The Department Should Clearly Grandfather Business Done While the DOL Rules are Being Reconsidered.**

The "grandfathering" provisions of the new rules have sown confusion regarding their applicability to certain retirement investment advice and transactions, with both existing and new clients. The recently announced delay in the DOL Rules' applicability date, coupled with the continued analysis of the rules at the direction of the President over the coming months, is highly likely to exacerbate this confusion. The Department should preempt this confusion with clear guidance to the industry and consumers.

The NPH firms have identified a number of situations where additional clarification is needed or a revised standard is necessary. These situations include the inability to clearly identify all established systematic investments (due to the lack of or inconsistent indicators with the mutual fund company or other product provider), inability to clearly identify changes to systematic investments or other new investments that may be triggered by advice, and inability to effectively

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<sup>35</sup> See also Patrick Lach, , *A Simple Alternative to the Fiduciary Rule*, Wall St. J., March 8, 2017, available at <http://blogs.wsj.com/experts/2017/03/08/a-simple-alternative-to-the-fiduciary-rule/>.

deal with new clients or accounts added after the Applicability Date that are not subject to the grandfather provisions. When coupled with concerns with holding positions direct with fund or annuity sponsors (as compared to a clearing arrangement), firms will be reluctant to allow new deposits into existing positions or accounts, and may be unwilling to allow new clients to transfer in positions that are not grandfathered.

The Department should state clearly and plainly that neither the new rules, nor any potential successor to them, will apply to any investment advice given, or sales effected, during the period of delay of the applicability dates. This clear statement is a first step. Thereafter, in any future revision or replacement of the rules, the Department should create a grandfathering framework that enables consumers to maintain and establish non-fiduciary relationships if the consumer chooses.

The existing grandfathering provisions in the DOL Rules are fundamentally flawed and obliterate consumer choice. Under the DOL Rules, a consumer who is satisfied with a longstanding non-fiduciary relationship is, in most instances, thrust into a fiduciary relationship when advice is first given after the applicability date of the rules. This creates a perverse incentive for representatives to refrain from communication with their clients after the applicability date. We therefore propose a framework that preserves consumer choice and gives consumers the option to “opt in” to a fiduciary relationship if the consumer chooses. Assuming a two-tiered framework, where firms and individuals can offer non-fiduciary or fiduciary advice, consumers should have a choice about how they want to engage with their adviser. If a consumer is currently engaged in a non-fiduciary (e.g., brokerage) relationship she wants to maintain, she should be able to maintain it. If the consumer prefers to switch to a fiduciary relationship that covers advice delivered in the future, she should be able to (and currently can) make this change of her own volition, and not be forced into this change by the Department.

Thank you for considering our views. NPH, together with Jackson, urges the Department to institute another delay of the portions of the DOL Rules scheduled to be applicable on June 9 and, ultimately, to repeal the DOL Rules. The DOL Rules as drafted will harm consumers and the vibrancy and diversity of the market for retail advice. We also encourage the Department to re-engage with other regulators and the industry to set a path forward that enhances the frequency with which consumers receive high quality, unbiased investment advice, while preserving consumer choice and encouraging access to, and utilization of, financial advice and guaranteed income products.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott Romine", with a stylized flourish at the end.

Scott Romine  
President/CEO