

American Federation of Labor and Congress of Industrial Organizations



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Submitted by e-mail to e-OED@dol.gov

July 21, 2015

Office of Exemption Determinations
Employee Benefits Security Administration
(Attention: D-11712)
U.S. Department of Labor
200 Constitution Avenue, NW
Suite 400
Washington, DC 20210

Re: Proposed Best Interest Contract Exemption
ZRIN: 1210-ZA25

Ladies and Gentlemen:

The American Federation of Labor-Congress of Industrial Organizations ("AFL-CIO") is pleased to submit these comments to the Department of Labor ("DoL") on the Notice of Proposed Class Exemption regarding the Best Interest Contract Exemption ("BICE").¹ Separately, the AFL-CIO is submitting comments to DoL on the Notice of Proposed Rulemaking

¹ The Notice was published in the Federal Register on April 20, 2015 (80 Fed. Reg. 21960) and is available at <http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08832.pdf>. DoL also has proposed other new exemptions and amendments to existing exemptions as part of its overall proposal related to fiduciary investment advice. The only exemption on which the AFL-CIO is submitting comments is the BICE. By notice published in the Federal Register on June 18, 2015 (80 Fed. Reg. 34869) available at <http://www.gpo.gov/fdsys/pkg/FR-2015-06-18/pdf/2015-14921.pdf>, the public hearing on the proposed rule and related proposed prohibited transactions exemptions ("PTEs") for August 10, 2015. The AFL-CIO will submit its request to testify at the hearing before the deadline of July 24, 2015.

regarding the definition of the term “fiduciary” of an employee benefit plan under Section 3(21) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) and of a plan under Section 4975 of the Internal Revenue Code of 1986 (the “Code”) as a result of giving investment advice (“Proposed Rule”).²

The AFL-CIO is a voluntary, democratic federation of 56 national and international labor unions that represent 12.2 million working people. We work every day to improve the lives of people who work for a living. We help people who want to join together in unions so they can bargain collectively with their employers for fair pay and working conditions and the best way to get a good job done. Our core mission is to ensure that working people are treated fairly and with respect, that their hard work is rewarded and that their workplaces are safe. Further, to help our nation build a workforce with the skills and job readiness for 21st century work, we operate the largest training network outside the U.S. military. We also provide an independent voice in politics and legislation for working women and men, and make their voices heard in corporate boardrooms and the financial system.

Union members have a lot at stake in the private-sector pension and retirement savings system:

- More than four-in-five (83%) union workers employed in private industry participate in workplace retirement plans, compared to just over two-in-five non-union workers (45%).³
- While most private-sector union workers are covered by defined benefit pension plans (66% compared to 11% of non-union workers), more than two-in-five (45%) participate in defined contribution plans—a greater share than non-union workers (42%).⁴
- More than one-in-four dollars in ERISA-covered retirement plans (27%)—totaling \$1.9 trillion in assets—are in collectively bargained defined benefit and defined

² The Notice was published in the Federal Register on April 20, 2015 (80 Fed. Reg. 21928) and is available at <http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08831.pdf>.

³ U.S. Dept. of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2014, Bulletin 2779* (Sept. 2014) t. 2 (private industry workers), available at <http://www.bls.gov/ncs/ebs/benefits/2014/ebbl0055.pdf>.

⁴ U.S. Dept. of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2014, Bulletin 2779* (Sept. 2014) t. 2 (private industry workers), available at <http://www.bls.gov/ncs/ebs/benefits/2014/ebbl0055.pdf>.

contribution plans.⁵

- Thousands of union members serve as fiduciary trustees jointly responsible with management-appointed representatives for administering retirement plans and overseeing the investment of retirement plan assets.
- Union workers and retirees from both the private and public sectors have retirement money invested through Individual Retirement Accounts (“IRAs”). Like non-union workers and retirees, many of them transfer money from workplace retirement plans into IRAs when they leave a job.

Background and Overview of the BICE

DoL has proposed a package of regulatory changes designed to ensure that retirement investors who seek out investment advice receive advice that is in their best interest and not tainted by financial conflicts of interest. This package includes two major components: (1) a proposed updated definition of “fiduciary” by reason of having given “investment advice;” and (2) several proposed new and amended prohibited transaction exemptions laying out the conditions under which a conflicted fiduciary adviser may provide advice.

Generally, the updated definition would result in more guidance activities being treated as fiduciary advice. It would remove several significant limitations and loopholes in the existing rule promulgated by DoL and Treasury in 1975 or adopted by DoL in subsequent interpretive guidance. The proposed definition would better align the regulatory definition of advice with both the full scope of the statutory definition and retirement investors’ reasonable expectations.

Through the proposed exemptions, DoL is exercising its authority granted by Congress under ERISA Section 408 to issue administrative prohibited transaction exemptions (“PTEs”) from the ban on a fiduciary engaging in certain transactions regarding the assets of a plan or IRA if the fiduciary has a conflict of interest. In most cases, these PTEs are in addition to, not replacements for, other existing statutory and administrative exemptions and guidance regarding the provision of advice.

The most significant new PTE, the BICE, would enable fiduciary advisers (with limited exclusions), to continue receiving compensation that otherwise would be considered a conflict of interest. The BICE would apply to investment advice given to plan participants or beneficiaries with self-directed accounts or authority to take a distribution, IRA owners, or plan sponsors of non-participant-directed plans with fewer than 100 participants (“Retirement Investors”). The exemption would apply only with respect to “Assets,” which are an enumerated list of investment products.

⁵ Calculated from U.S. Dept. of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2012 Form 5500 Annual Reports* (Jan. 2015 v. 1.2) t. A6, available at <http://www.dol.gov/ebsa/pdf/2012pensionplanbulletin.pdf>.

In order for a conflicted fiduciary advice provider to be eligible for the exemption, several key conditions would have to be satisfied.

Prior to providing advice, an adviser and the associated financial institution must enter into a written contract with the Retirement Investor.⁶ The contract must include the following terms:

- *The adviser and financial institution are fiduciaries under ERISA and the Code with respect to any investment advice provided to the Retirement Investor.*
- *The adviser and financial institution agree to and comply with specified impartial conduct standards (best interest advice, reasonable compensation, and no misleading statements).*
- *The adviser and financial institution warrant compliance with applicable, relevant federal and state laws, as well as adoption of policies and procedures and the adherence to practices designed to identify and mitigate material conflicts of interest.*
- *The written contract identifies material conflicts of interest, informs the Retirement Investor of her right to obtain fee information, and discloses whether the financial institution receives third-party payments with respect to an asset and where to get more information about that.*

The contract cannot either disclaim or limit the liability of the adviser or financial institution for contract violations, or waive or qualify the Retirement Investor's right to bring or participate in a class action lawsuit.

Certain disclosure requirements related to the Retirement Investor and the public must be satisfied.⁷ Before an asset is purchased, the adviser must provide the Retirement Investor with a chart showing the total cost of investing in each recommended asset for 1-, 5- and 10-year periods. The adviser or financial institution must provide each Retirement Investor with annual summary information about asset transactions, fees and expenses and adviser and financial institution compensation. The financial institution must maintain a publicly-accessible website that discloses information about the amounts and sources of compensation payable to the adviser and financial institution and how the compensation varies within and among assets.

The financial institution must offer and the adviser must make available to the Retirement Investor a range of investments broad enough for the adviser to make recommendations on all of

⁶ Proposed Section II at 80 Fed. Reg. 21984-21985.

⁷ Proposed Section III at 80 Fed. Reg. 21985.

the asset classes reasonably necessary to serve the Retirement Investor's best interests.⁸ A financial institution can limit the range of investment products offered based on factors such as whether the products are proprietary or generate third-party payments, so long as specified conditions designed to protect and promote the Retirement Investor's best interests are met. Special rules are proposed with respect to advice provided to participants and beneficiaries in self-directed individual account plans with investment option menus selected by an independent plan fiduciary.

The financial institution must satisfy several requirements related to disclosures, recordkeeping, and data maintenance.⁹ This includes notification to DoL if it intends to rely on the BICE, as well as the maintenance of any records needed to determine satisfaction of the BICE conditions and specified information regarding asset inflows, outflows, holdings and returns for six years.

DOL also proposes including two supplemental exemptions together with the BICE. One—the Insurance and Annuity Exemption—permits the purchase of insurance or annuity products from an insurance company that is a service provider to the plan or IRA, under specified conditions.¹⁰ The other—the Exemption for Pre-Existing Transactions—permits an adviser and her firm to receive otherwise prohibited compensation related to advice provided before the date on which the new investment advice rule becomes effective, under specified conditions.¹¹ We are not commenting on these exemptions at this time.

Overarching Concerns

We are deeply concerned that many financial institutions currently choose to pay financial advisers in ways that incentivize them to provide investment advice that is not in the best interests of their Retirement Investor clients. DoL's Regulatory Impact Analysis clearly demonstrates the harm from financial conflicts in the form of higher-than-appropriate fees and expenses and lower returns. That analysis confirms that differential compensation levels that are unrelated to any neutral factor are likely to encourage advice that is not in the best interests of Retirement Investors.

Left unaddressed or if reforms are delayed yet again, these conflicts will inflict greater and greater harm on workers and retirees, especially as they rely increasingly on individual retirement accounts to supplement Social Security. Further, these conflicts will erode

⁸ Proposed Section IV at 80 Fed. Reg. 21985-21986.

⁹ Proposed Section V at 80 Fed. Reg. 21986.

¹⁰ Proposed Section VI at 80 Fed. Reg. 21986-21987.

¹¹ Proposed Section VII at 80 Fed. Reg. 21987.

Americans' confidence in the financial markets and reinforce the public's perception that, in the halls of government, Wall Street's interests trump those of Main Street.

DoL's proposal to adopt a common-sense definition of fiduciary investment advice is an essential step in restoring confidence in the private retirement system. It ensures that this system in fact serves the best interests of the retirement investors for whom it was created.

We are mindful that Congress also gave DoL administrative authority to grant exemptions from the prohibited transaction rules so long as the Secretary of Labor finds an exemption to be administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of the participants and beneficiaries and IRA owners.¹² In laying out these conditions, Congress appropriately set a high bar. In our view, such a finding can be made with respect to the provision of conflicted investment advice only if an exemption is conditioned on compliance with substantive protections that go well beyond disclosure of financial conflicts, in fact mitigate harmful conflicts of interest, and require advisers and financial institutions to commit to an appropriate duty of care to their Retirement Investor clients.

High-quality investment advice provided solely in the interest of retirement investors and not biased by financial conflicts of interest is critical to ensuring that the private pension and retirement savings system actually meets the needs of the workers and retirees it was created to serve. We believe the BICE as proposed will lead to retirement investors receiving advice that is in their best interest when a fiduciary adviser has a financial conflict of interest. Further, we believe the Secretary may reasonably find and should find that the BICE as proposed satisfies the statutory requirements for granting a prohibited transaction exemption. Therefore, the AFL-CIO strongly supports granting the exemption as proposed, with additional strengthening conditions as appropriate.

Critics of the Department's proposal have charged that reforms that address harmful conflicts of interest will increase costs for Retirement Investors. Such assertions are fundamentally misleading. Retirement Investors are paying huge costs for conflicted advice; the costs are just hidden. As DoL establishes in its Regulatory Impact Analysis, IRA holders receiving conflicted advice can expect their investments to underperform by an annual average of 100 basis points. In the mutual fund segment alone, this conflict-driven underperformance could cost IRA investors more than \$210 billion over the next 10 years and nearly \$500 billion over the next 20 years.¹³ Bringing these kinds of costs out in the open will create genuine choice and help prevent overpaying.

¹² ERISA § 408(a). Internal Revenue Code § 4975(c)(2).

¹³ U.S. Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis* (Apr. 21, 2015) p. 7, available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>. (“Regulatory Impact Analysis”)

Covered Transactions

We generally support the proposed limits on transactions eligible for the BICE included in Section I(b).¹⁴

With respect to plan sponsor fiduciaries, we believe DoL has struck the right balance between the needs of large and small plan sponsors, restricting the BICE to advice provided to a plan sponsor of a non-participant-directed plan with fewer than 100 participants.¹⁵ In our experience, large plan sponsors are sophisticated users of professional advisers with ready access to conflict-free advice and therefore do not need access to the BICE. Further, the sales exclusion from the definition of fiduciary investment advice included in the Proposed Rule¹⁶ appropriately addresses circumstances in which a conflicted adviser may make recommendations regarding the investment of a large plan's assets to an independent plan fiduciary with financial expertise without the adviser being considered a fiduciary.

We suggest DoL provide additional guidance clarifying whether and under what circumstances the BICE applies when an adviser makes a "recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA." We address this issue in more detail below.

Definition of "Asset"

We support the proposed definition of "asset"¹⁷ to which the provision of conflicted investment advice would be limited under the BICE. The broad list of investment products enumerated in the definition is more than adequate to enable a conflicted adviser to make recommendations that serve the best interests of small-plan and individual retirement investors, while limiting the use of investment products that provide greater opportunities for conflicted advisers to provide advice that violates the BICE's contractual standards of conduct. Conflicted advice could still be provided with respect to other permitted investment vehicles, such as mutual funds, that invest in otherwise off-list products.

It is important to note that the proposed definition of "asset" applies only in determining whether a transaction is covered under the BICE. The definition does not otherwise limit the investment products in which a plan, participant or beneficiary account, or IRA can be invested. Although off-list products not readily available through other permitted investment vehicles likely will be of interest to only a small segment of Retirement Investors, a Retirement Investor

¹⁴ 80 Fed. Reg. 21984.

¹⁵ Proposed Section I(b) at 80 Fed. Reg. 21984.

¹⁶ Proposed Section 2510.3-21(b)(i) at 80 Fed. Reg. 21957.

¹⁷ Proposed Section VIII(c) at 80 Fed. Reg. 21987.

may still choose to invest in such products. Further, a Retirement Investor will continue to have access to advice on off-list investment products by seeking recommendations from conflict-free advisers or advisers who satisfy another exemption. Retirement Investors who seek out more complex, less transparent, or more illiquid investments are likely in a better position to acquire advice outside the BICE structure.

Written Contract and Prohibited Contractual Provisions

We support the requirement that advisers and financial institutions enter into a written contract with Retirement Investors before advice is provided.¹⁸ We suggest DoL consider requiring the contract be provided to Retirement Investors, especially individuals, as a separate document that is not combined with or integrated into any other agreement or disclosure.

The contract will provide substantial benefits to Retirement Investors by clearly defining the terms of their relationship with financial advisers, regardless of the title an adviser may use for marketing purposes or how she is otherwise regulated under other federal or state laws. We note that research shows that individual investors typically express confusion about the many different titles used by financial advisers and the duties owed by those advisers and financial institutions to their clients. The BICE-required contract will address this confusion and any ambiguities about the legal responsibilities of the adviser and the financial institution to the Retirement Investor.

Clearly defining an adviser's and financial institution's status and commitment to specified standards of conduct are essential to ensuring the proposed exemption is in the interests of the plan, participants and beneficiaries, and IRA owners and protective of the rights of participants and beneficiaries and IRA owners. The BICE-required contract will create clear standards that apply across all transactions covered by the BICE, with no distinction between those involving the assets of plans covered by Title I of ERISA and those involving the assets of IRAs. Its clear statement that the adviser and financial institution are fiduciaries with respect to any advice being given will avoid unnecessary disputes about their status. The required warranties, discussed in more detail below, will ensure that harmful conflicts of interest that encourage violation of the standards of conduct are addressed affirmatively through financial institution policies and procedures and actual changes in compensation practices.

The BICE contract is essential to protecting the rights of Retirement Investors because it creates a right of action for breaches of the contract by advisers and financial institutions. This is particularly important for IRA owners who do not have an individual statutory right of action and otherwise would have to rely on the IRS to protect their interests and enforce the terms of an exemption.

¹⁸ Proposed Section II at 80 Fed. Reg. 21984-21985.

Warranties, Mitigation of Conflicts, and Permissible Variability in Compensation

We support the required contractual warranties by the adviser and financial institution relating to (1) compliance with all applicable and related state and federal laws, (2) adoption of written policies and procedures reasonably designed to mitigate the impact of material conflicts of interests and ensure adherence to the BICE impartial conduct standards, (3) identification of material conflicts of interest and adoption of measures to prevent those material conflicts of interest from causing violations of the impartial conduct standards, and (4) absence of use by the financial institution (including any affiliate or related entity) of actions or incentives that tend to encourage recommendations that are not in the Retirement Investor's best interest.¹⁹ Further, we strongly oppose material changes that would have the effect of weakening the obligation to identify and mitigate conflicts of interest.

In our view, this broad approach provides sufficient flexibility to advisers and financial institutions to continue, adapt, and develop a range of business models for delivering investment advice while protecting and promoting Retirement Investors' rights and interests. We are aware of complaints by financial institution representatives that financial institutions may have to change how they pay advisers and how Retirement Investors pay for advice under the approach proposed by DoL. That, of course, is the point. As DoL's Regulatory Impact Analysis amply demonstrates, some financial institution's existing compensation structures encourage recommendations that harm Retirement Investors. We expect the gains to Retirement Investors will significantly outweigh any costs needed to implement these changes.

We generally support DoL's distinction between compensation structures and related incentives that tend to encourage individual advisers to make recommendations that are not in the best interest of a Retirement Investor or otherwise to violate the impartial conduct standards of the BICE, and those that do not encourage such inappropriate advice. We believe the examples of compensation structures that could help satisfy the warranty requirement regarding material conflicts provided in the preamble are reasonable and appropriate, except as they would apply in circumstances that include advice related to plan distributions (see discussion below). The guidance included in the BICE regarding variable compensation arrangements based on neutral factors is also appropriate. We note, however, that factors such as differences in the time and analysis needed to provide prudent advice for different types of investments need to be rooted in empirical assessments of the actual differences in time and analysis required. Absent such assessments, these differences can easily be used as a subterfuge to justify compensation arrangements that incentivize the provision of advice that favors specific investments irrespective of the best interests of the Retirement Investor.

¹⁹ Proposed Section II(d) at 80 Fed. Reg. 21984.

Recommendations Related to Plan Distributions

The BICE covers compensation received “for services provided in connection with” certain transactions involving an asset of a plan, participant or beneficiary account, or IRA “as a result of...advice” to a participant or beneficiary of a plan with authority to take a distribution, among others.²⁰ It is unclear whether a recommendation to take a distribution would be considered part of the advice from which the compensation-generating transaction resulted.

Given the frequency with which this circumstance occurs and the inordinately high stakes for individual Retirement Investors, we urge DoL to address this issue through more explicit guidance as to whether and in which circumstances the BICE applies in connection with recommendations to take a distribution from a plan. If DoL intends the BICE to apply, we urge the Department to consider strengthening the conditions that must be met for an adviser and a financial institution to be eligible for the exemption, especially in regard to the warranties related to material conflicts of interest.

If DoL intends the BICE to apply, the Department should clarify whether its examples of compensation structures that could help satisfy the contractual warranties relating to material conflicts would be relevant to these kinds of conflicts. Additional guidance could include new examples of compensation structures that specifically address this conflict.

Further, DoL should consider imposing additional conditions to ensure the best interests of Retirement Investors are promoted and protected. The nature of an adviser’s financial conflict of interest can be meaningfully different when the advice includes a recommendation to take a distribution of benefits, such as a lump sum distribution from a pension plan in lieu of an annuity benefit. In such a case, any arrangement in which compensation paid to an adviser is directly or indirectly contingent on the assets being distributed from the plan is on its face a material conflict of interest that will tend to encourage advisers to make recommendations that are not in the best interest of Retirement Investor clients. For example, if a financial institution pays an adviser a percentage, which does not vary based on the types of investments, of the dollar amount of assets invested by an IRA with the adviser but nothing for the dollar amount of assets that remain within a plan, then the compensation paid to the adviser does in fact vary enormously based on the adviser’s recommendations.

Disclosure Is Insufficient, Even when Combined with a Best Interest Standard

We are aware of calls by some financial industry representatives to replace the BICE with an exemption that pairs a best interest standard of care merely with disclosure of an adviser’s conflicts of interest. Such an approach is neither in the interests of retirement investors nor protective of the rights of participants and beneficiaries of the plan or IRA owners. Disclosure alone will not mitigate conflicts of interest in investment advice. Even if we could be certain that such disclosure would be read and it could be made simple and clear—assumptions we do not

²⁰ Proposed Section I(b)(1) at 21984-21985.

take for granted—it might, in fact, be not only ineffective, but also harmful. DoL’s Regulatory Impact Analysis cites several academic studies demonstrating the ways in which disclosure alone is an inadequate remedy with unintended consequences, one of which is that advice recipients might interpret the disclosure of conflicts as a sign of honesty, rather than a red flag.²¹ Given this, the Secretary would not be able to make the findings needed to issue such an exemption that does not include meaningful requirements that financial conflicts be mitigated.

Range of Investment Options

We support conditioning the exemption on the financial institution offering and the adviser making available to the Retirement Investor a range of investments that is broad enough for the adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the best interests of the Retirement Investor in light of its specific investment objectives, risk tolerance, and specific financial objectives.²²

When a financial institution limits the assets made available, it should be able to make a general finding with respect to its current and potential Retirement Investor clients that it offers a sufficient range so long as it makes available investments covering all asset classes reasonably necessary to serve the best interests of any reasonably likely client. A financial institution that does not satisfy this broad standard, but would like to take advantage of the BICE, should be required to make this determination on an investor-by-investor basis. For any institution that limits the assets made available, we support requiring written pre-advice disclosure of the limitations that have in fact been imposed. We agree that the notice should not be permitted to use vague language that merely suggests that investment recommendations “may” be limited.

We greatly appreciate the opportunity to submit these comments. Please do not hesitate to contact me with any questions you may have about them.

Very truly yours,

/s/ Shaun C. O’Brien

Shaun C. O’Brien
Assistant Policy Director for Health and Retirement

²¹ U.S. Dept. of Labor, Employee Benefits Security Administration, Fiduciary Investment Advice Regulatory Impact Analysis (Apr. 12, 2015) pp. 194-197, *available at* <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>.

²² Proposed Section IV at 80 Fed. Reg. 21985-21986.