



Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

July 21, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Conflict of Interest Rule, RIN 1210-AB32
Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25

Dear Sir or Madam:

We are writing on behalf of Americans for Financial Reform (AFR) to comment on the Department of Labor's (DOL) proposed rules changes to better protect retirement savers from conflicted investment advice.¹ In our view, these proposals represent a critical and long overdue improvement of investor protections mandated by the Employee Retirement and Income Security Act (ERISA). We support these reforms, with the proviso that the protections currently in the rule against possible abuses of exemptions and exclusions must be maintained in full.

ERISA contains powerful statutory protections for retirement savers. Section (3)(21) of ERISA designates individuals or entities as fiduciaries to a retirement plan if:

- A) They exercise any discretionary authority regarding plan management or assets, or
- B) They render investment advice for any fee or other compensation, direct or indirect, regarding any moneys or other properties of the plan.

Fiduciaries are personally liable for any losses caused by a breach of their fiduciary duty.

This statutory framework is straightforward and direct, and is clearly intended to apply the fiduciary duty broadly. The breadth and force of the statutory framework shows that Congress

¹ Americans for Financial Reform is a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

was deeply concerned that retirement investors receive advice that is free of conflicts of interest, provided by fiduciary advisors who are required to put the interests of the investor first.

However, in implementing the statute the Department of Labor in 1975 issued regulations that placed significant additional restrictions on the application of fiduciary duties to providers of investment advice. The 1975 regulation added a five-part test, each prong of which must be satisfied before an individual or entity can be considered as giving ‘investment advice’ that triggers ERISA fiduciary status. The five part test requires that an advisor must (1) render advice, (2) on a regular basis, (3) pursuant to a mutual agreement, (4) that the advice will serve as the primary basis for investment decisions with respect to plan assets, and (5) that the advice is individualized to the particular plan or saver. If even one of these requirements is not met, the fiduciary duty protection is not triggered.

This five part test has no apparent basis in statute. Presumably the original intent of the test in 1975 was related to a desire to exclude merely incidental advice and focus fiduciary protections on truly significant advice. This justification was questionable even at that time. But in the forty years since the 1975 rule was passed the retirement savings markets have transformed in ways that make the five-part test enormously more damaging to worker interests. In 1979, 84 percent of workplace retirement plan participants were members of a defined benefit plan managed by their employer, and just 16 percent were exclusively dependent on a defined contribution plan where they made their own investment decisions. Today, the percentages have reversed, with 93 percent of workplace retirement plan participants members of a defined contribution plan.²

With individual workers more responsible than ever before for their own investment decisions, and less protected by larger employer fiduciaries, investment advice that does not meet every prong of the five-part test can have a crucial impact on investment choices. Workers may rely on investment advice that is provided on a one-time or intermittent basis, or cannot be documented as being the primary basis for an investment decision, or is not provided pursuant to a demonstrably mutual agreement, without realizing that the DOL permits the provider of such advice to prioritize their own interests or financial returns over the interests of the investor.

Such conflicted advice can have an especially devastating effect in the case of lump-sum rollover decisions, such as moving retirement savings from a 401-K into an IRA. This can be one of the most important decisions a worker will ever make concerning their retirement savings. Yet under a 2005 advisory opinion, advice on this decision, even when it includes investment recommendations, does not trigger a fiduciary duty.³ IRA rollovers are a major part of the retirement investment landscape, accounting for an estimated 40 to 50 percent of the new

² Employee Benefit Research Institute, “[FAQ About Benefits – Retirement Issues](#)”

³ Department of Labor Advisory Opinion 2005-23A, December 7, 2005.

monetary flows to investment advisors and brokerages.⁴ As such, they are a major contributor to profits in the fund management industry, and fund managers are aggressively targeting the IRA rollover market.⁵

A recent GAO report found that conflicts of interest were driving poor advice in the IRA market.⁶ The report concluded that:

“much of the information and assistance participants receive is through the marketing efforts of service providers touting the benefits of IRA rollovers and is not always objective. Plan participants are often subject to biased information and aggressive marketing of IRAs when seeking assistance and information regarding what to do with their 401(k) plan savings when they separate or have separated from employment with a plan sponsor. In many cases, such information and marketing come from plan service providers. As we have reported in the past, the opportunity for service providers to sell participants their own retail investment products and services, such as IRAs, may create an incentive for service providers to steer participants toward the purchase of such products and services even when they may not serve the participants best interests.”

A recent study by Harvard economists used audit techniques to test advice received on IRA rollovers, and also found clear evidence that brokers and advisors routinely provided misleading and deceptive advice driven by conflicts of interest.⁷

Conflicts of interest in the investment market create enormous costs for retirement savers. Based on a comprehensive review of economic evidence, the DOL’s Regulatory Impact Analysis provides a conservative estimate of losses to investors in the IRA mutual fund market alone of \$210 billion over the next decade. Losses due to other types of instruments affected by broker conflicts of interest, such as insurance and ETFs, would be in addition to that figure.

⁴ Turner, John and Bruce Klein, [“Retirement Savings Flows And Financial Advice: Should You Roll Over Your 401\(K\)?”](#), Pension Policy Center, April 2014.

⁵ McKinsey Wealth Management, Asset Management, and Retirement Practice, “Capturing IRA Rollovers: The Net New Money Opportunity for Wealth Managers”, McKinsey Consulting, July 2011. McKinsey Wealth Management, Asset Management, and Retirement Practice, [“Searching for Growth In Asset Management”](#), McKinsey Consulting.

⁶ Government Accountability Office, [“401\(K\) Plans: Labor and IRS Could Improve the Rollover Process for Participants”](#), GAO Report 13-30, March 7, 2013.

⁷ Mullainathan, Sendhil, Markus Noth and Antoinette Schoar, [“The Market For Financial Advice: An Audit Study”](#), NBER Working Paper 17929, National Bureau of Economic Research, March 2012.

In light of these costs, and the large and evident gaps in ERISA fiduciary coverage outlined above, it is imperative that fiduciary coverage be reformed. To be effective, any such reform must meet several standards:

- Obsolete limitations on ERISA fiduciary coverage such as the ‘regular basis test’ and the ‘primary basis test’ should be eliminated. So should requirements such as a ‘mutual agreement’ that will be difficult for less sophisticated individual investors to document.
- The rule must cover rollovers of employee retirement plan assets to IRAs as fiduciary investment advice. Indeed, all advice related to distributions from a retirement plan should be so covered.
- Carve-outs from the investment advice definition must be carefully and narrowly defined.
- Prohibited transaction exemptions must be carefully controlled to ensure that the conflicts of interest inherent to prohibited transactions do not lead to violations of the fiduciary obligation to put client interests first.
- The fiduciary duty of ERISA-covered advisors must be practically enforceable.

This rule proposal appears to meet the first standard, as it eliminates the regular and primary basis tests, as well as the explicit requirement for a *mutual* agreement. AFR strongly supports the elimination of these inappropriate tests, which permit evasion of appropriate fiduciary duties.

However, the proposal continues to require that in cases where fiduciary status is not explicitly acknowledged, advice must be provided ‘pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized to, or that such advice recipient is specifically directed to, the advice recipient for... decisions with respect to securities or other properties of the plan or IRA’. We believe that this requirement should be clarified to specify that such an agreement or understanding need not be mutual or explicitly spelled out in detail. If the recipient of the advice is reasonably led to believe that the advice is specifically directed to him or her and applies to plan assets, this should count as an ‘understanding’ for the purpose of triggering the fiduciary duty. The purpose of such a clarification would be to avoid situations where the advisor or broker claims that they did not share the client’s understanding that the advice was individualized or intended to apply to plan assets, in order to dispute whether the agreement existed. This could in effect reintroduce the requirement for a mutual agreement. It is unreasonable to expect a retail investor who may not be familiar with legal details to be responsible for documenting proof that an agreement or understanding is mutual and explicit.

The proposal also meets the second standard, as advice concerning distributions and rollovers is explicitly covered as fiduciary investment advice. AFR strongly supports this. Clearly distributions and rollovers can be crucial financial decisions affecting plan assets.

The expansion of the application of fiduciary duties in this proposal is counterbalanced by a large number of carve-outs and exemptions. The range and scope of these carve-outs and exemptions show that the DOL has made extensive efforts to accommodate industry concerns that current business models are not compatible with a genuine and enforceable fiduciary duty to act solely in the client's best interests. We would note that the goals of expanding the fiduciary duty will not be met unless current business models are changed, and changed significantly. The entire thrust of the Regulatory Impact Analysis is that current business as usual results in unjustified costs of hundreds of billions of dollars to retirement investors. Given that these costs also represent hundreds of billions in revenues transferred to financial services providers, we can expect strong efforts to further weaken the rule to protect existing business models and profits. While a number of the proposed carve-outs are reasonable and there are a range of protections currently included for some of the important exemptions, significant changes in the proposal to further accommodate industry concerns threaten to undermine the core objectives of this rule.

Below, we briefly discuss a number of specific carve-outs and exemptions. We may comment further or provide additional detail in the future on other exemptions not covered here or on the concerns expressed below.

The proposal excludes information provided as part of arms-length sales transactions from the definition of fiduciary advice. We support the limitation of this exclusion to larger plans (100+ employees or \$100 million+ in assets), as well as the specification that the non-fiduciary role of the seller must be disclosed and the seller must have a reasonable basis to believe that the plan representative is sophisticated. These qualifications are necessary to ensure that the sales exemption will not be used to provide potentially deceptive advice to unsophisticated clients.

The proposal excludes investment education materials from the definition of advice, so long as such materials are general and not individualized to recommend a particular product or products. In principle we agree that truly generalized investment education should be excluded from the investment advice definition. However, we believe it is important to ensure that 'educational' products that result in recommending a specific product as particularly suited to the client's situation be covered as advice, regardless of any provisos or disclosure that the recommendation does not constitute 'advice' under ERISA. We therefore support the DOL's provision that asset allocation models that result in particularized recommendations to the client not be counted as investment education.

The proposal provides a new prohibited transaction exemption that permits fiduciaries to receive compensation that would otherwise be prohibited as creating a conflict of interest, so long as a range of carefully specified conditions are met. This ‘Best Interest Contract Exemption’ (BICE) permits otherwise prohibited compensation so long as the advisor contractually commits to giving fiduciary advice in the best interests of the clients, contractually commits to standards of impartial conduct, and provides a contractual warranty that it has policies and procedures in place to mitigate the impact of conflict of interests resulting from otherwise prohibited compensation. We would note that given the voluminous evidence collected in the DOL’s Regulatory Impact Analysis as to the negative effect on investors created by precisely the forms of compensation permitted under the BICE, it is crucial that protections under the BICE be both extensive and enforceable. The lack of such effective protections will simply result in reintroducing through the back door the exact forms of conflict of interest and exploitation that the proposal is designed to prevent.

We therefore support the full range of protections required by the DOL to take advantage of the BICE, including the specific contractual commitments and warranties related to fiduciary advice commitments, impartial conduct, and policies and procedures that support these commitments. We also view it as crucial that these contractual commitments be directly enforceable by individual IRA owners, plan beneficiaries, and plans through legal action. Limitations on such enforcement powers would threaten to turn the required contractual commitments into a mere paperwork exercise. Given the significant costs of undertaking legal action, and the well-developed body of case law concerning fiduciary duties as well as the likelihood that this case law would be further developed as experience is gained with BICE-type contracts, there is every incentive for such legal action to occur only in meritorious as opposed to frivolous cases.

We further support the required point-of-sale cost disclosures. Such disclosures should be provided before the point that the transaction is finalized, and should be both prominent and understandable. These disclosures will of course be enormously helpful to clients seeking to understand their investment options. But beyond that, they provide incentives to sellers of financial products to conform to fiduciary commitments, as unjustified differences in costs will be more evident both to clients and to brokers. Indeed, given the great complexity of summarizing bottom-line costs under current investment disclosure regimes, such disclosure requirements are likely to increase market efficiency.

However, we do have concerns regarding the potential addition of a ‘low free streamlined exemption’ to the BICE. Such an instrument-based exemption has some theoretical appeal, and a narrow exemption for a carefully limited set of simple instruments could be valuable. But in practice its implementation could be very problematic. An overly broad version of such an exemption could undermine or even eliminate many of the protections referred to above, including some of the most important ones such as the express commitment to a best interest

standard. It would be ironic if the DOL, having worked to develop a detailed set of restrictions on the BICE, then provided a broad exit clause from these restrictions.

We are particularly concerned given the DOL's statement that "there may be no single objective way to evaluate fees and expenses associated with mutual funds (or other investments) and no single cut-off to determine when fees are sufficiently low" for such an exemption. The implication that clear objective standards for the exemption may be impossible to determine seems to indicate that the exemption could be complex, technical, and vulnerable to exploitation. If any streamlined exemption to the BICE is added, it should be carefully limited and only finalized after additional public consultation.

In sum, this proposal as a whole contains a long overdue and extraordinarily valuable expansion of the ERISA fiduciary duty to address numerous loopholes that inappropriately limit the application of best interest protections. As the Regulatory Impact Analysis indicates, these uncontrolled conflicts of interest create enormous costs for retirement investors. Yet the rule also contains a wide variety of exemptions and exclusions that, if not properly controlled, could permit conflicts of interest to continue. We urge the DOL to include appropriate controls in the final rule, and to reject attempts to accommodate existing business models that profit through the exploitation of conflicts of interest.

Thank you for the opportunity to express our views on this proposal. Should you have additional questions on this issue, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,
Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute

- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development

- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)

- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network

- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET