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July 21, 2015

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

Re: RIN 1210-AB32: Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice
ZRIN 1210-ZA25:

- Proposed Best Interest Contract Exemption
- Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs
- Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks
- Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters
- Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75-1, Exemptions From Prohibitions

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- Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks
- Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1

To Whom It May Concern:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

The Department of Labor has solicited comment on whether it should replace its 1975 regulations with a new definition of fiduciary investment advice. PIABA agrees that the new definition is a better reflection of the broad scope of the statutory text and its purpose, and will better protect investors from conflicts of interest, imprudence and disloyalty. The Department of Labor has issued a notice of proposed rulemaking as well as several proposed class exemptions, and in connection therewith, solicits comment on each.

This comment letter will primarily focus on the delivery of investment advice to retail investors and those contemplating whether they should roll over their employer sponsored retirement plans into IRAs. Members of PIABA represent investors who have received flawed investment advice from brokers, oftentimes in connection with their retirement accounts. Our members have seen firsthand the harm that has resulted from the current system. Retirement investors will continue to be harmed if the status quo is maintained. The stories referenced in this letter describe events that have happened to actual investors. There are significant flaws in the system that can only be eliminated through remedial action. While PIABA agrees that investors would benefit from greater protection in all of their investment accounts, including non-retirement accounts, retirement funds hold special significance and deserve special protection immediately.

When the Employee Retirement Income Security Act of 1974 (ERISA) was enacted, Congress recognized that retirement savings deserved special protections. Congress extended protections to IRAs as well through the Internal Revenue Code of 1986 (the Code). As individuals enter retirement, it is critical that their nest eggs that they have spent their lifetime earning and building are protected. Both ERISA and the Code provided that certain individuals who provided advice to retirement accounts would be considered fiduciaries. If these individuals violated their fiduciary duty to their customers, both ERISA and the Code established penalties, thereby providing some level of protection for investors. However, currently, many individuals who provide advice to investors holding retirement accounts are not considered fiduciaries under ERISA and the Code, leaving a large gap in investor protection. Most importantly, many brokers are not deemed fiduciaries by either ERISA or the Code. The expanded definition of fiduciary under the proposed rule would change that, thereby finally closing the investor protection gap that has existed for the last few decades.

Investment advice is typically provided to investors by two different types of financial advisors: investment advisers and brokers. Each is subject to different regulatory regimes, although there is some overlap in those who enforce the regulations. Investment advisers are subject to the Investment Advisers Act of 1940 (the "Advisers Act") and the rules promulgated thereunder as well as state statutes and regulations. The Securities and Exchange Commission (the "SEC") and the state securities regulators enforce those statutes and regulations. Brokers are governed by the Securities Exchange Act of 1934 (the "Exchange Act") and the rules enacted thereunder as well as by state statutes and regulations. In addition, brokers are regulated by the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization and are subject to the rules established by FINRA.

Investment advisers must adhere to a fiduciary duty standard, which is derived from judicial interpretations of the Advisers Act. The fiduciary duty is defined by case law to include the duty of loyalty and care, and the obligation to always put the client's interests before and above the investment adviser's own interests when he interacts with a client. Brokers, on the other hand, must adhere to a suitability standard which is premised on a FINRA rule, and requires that a broker have a reasonable basis for believing that a recommendation of a security or an investment strategy is "suitable" for a client, based on the client's investment profile. It should be noted, however, that a number of states impose a fiduciary duty upon brokers as a matter of common law. Thus, brokers are subject to the suitability standard and may also be subject to a fiduciary standard depending on the state in which they are doing business and the nature of their relationship.

A retirement investor receiving investment advice could receive advice from someone who owes them a fiduciary duty, or someone who only owes them the lesser suitability standard. The overwhelming majority of investors do not understand with whom they are doing business.

Investors' ability—or inability—to distinguish between investment advisers and brokers is aggravated by the industry's confusing use of titles like "Financial Advisor," "Wealth Management

Specialist," and "Vice-President of Investments" for brokers. In fact, there are so many various professional designations available that FINRA has an entire section of its website devoted to defining these designations. The North American Securities Administrators Association ("NASAA") also recognized this as a problem and adopted a model rule prohibiting the misleading use of senior and retiree designations to address concerns over particularly troubling designations.[1]

Although the brokerage industry argues that retirement investors understand the services offered by investment professionals, and choose the individual and service that best suits their needs, most investors don't know the difference between brokers and investment advisors – and the industry is well aware of that fact. The simple truth is that more than three out of four investors don't understand that the current laws and rules impose different duties on brokers and investment advisers, according to a 2010 survey conducted for the Consumer Federation of America (CFA), AARP, the Investment Adviser Association, the Financial Planning Association, the CFP Board, the North American Securities Administrators Association (NASAA), and the National Association of Personal Financial Advisors.[2] More recently, a 2015 study confirmed that most retail customers think their financial advisor – regardless of which type of advisor it is – is a fiduciary.[3] The industry is well-aware of the confusion. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said "investors don't understand the differences between brokers and investment advisers."[4]

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[1] *See* "State Securities Regulators Announce New Model Rule on the Use of Senior Certifications and Professional Designations," NASAA, April 1, 2008, available at http://www.nasaa.org/5685/state-securities-regulators-announce-new-model-rule-on-the-use-of-senior-certifications-and-professional-designations/.

[2] *See* Infogroup/ORC, "U.S. Investors & The Fiduciary Standard: A National Opinion Survey," September 15, 2010, available at http://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf?sfvrsn=2.

[3] *See* Spectrem Group, "Fiduciary – Do Investors Know What It Means," 2015, available at http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf

[4] *See* "Trustworthy Advice and Individual Investors: Will Regulators Act in Investors' Best Interest?" issued in August 2013 to report the findings of the 2013 fi360-ThinkAdvisor Fiduciary Survey, available at http://www.fi360.com/uploads/media/fiduciarysurvey_resultsreport_2013.pdf; see also "Seeking Trustworthy Advice for Individual Investors – Financial Intermediaries Indicate Strong Support for Fiduciary Standard" issued in February 2015 to report the findings of the 2015 fi360 Fiduciary Standard Survey, available at http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf; and "Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants," a report published by the AARP in September 2013 (majority of participants concerned investment advice by plan providers not held to fiduciary standard). All related documents available at

This confusion leads to investors seeking advice from individuals who they mistakenly believe are looking out for their best interests. The current system cannot continue as it is and adequately protect retirement investors. Investors suffer billions of dollars in losses each year due to conflicted financial advice. Every day, retirement investors receive conflicted advice which is not in their best interests which frequently leads to a drag on returns in their accounts, or a decline in their account value. Below is a story from investors who had to file a FINRA arbitration to recover their losses.

- *William, an 80 year old retired plumber, and his wife, Elizabeth, were long standing members of Nativity Parish in Overland Park, Kansas. They met their broker, Charles, at their church, where he was also a member. The broker Charles recommended that the couple invest in a closed end mutual fund, which was a proprietary product of the brokerage firm that employed Charles. He invested William's IRA in the fund and almost all of Elizabeth's trust account. This was the couple's retirement savings which represented a lifetime or work and frugality. Charles earned a substantial commission by choosing this particular product because the mutual fund was a proprietary product of the brokerage firm. As a result of his conflicted advice regarding this investment, the couple lost a substantial amount of their retirement savings, $50,000 in a little over a year, money they did not have time to re-earn at that late stage of their lives. Since Charles was only a broker, he did not owe William and Elizabeth a fiduciary duty. His only obligation was to follow FINRA's suitability standard. He justified his recommendation to invest the majority of the couple's retirement savings into the mutual fund by saying it was a suitable investment, and that fact that Charles was financially incentivized to choose this particular investment over others was irrelevant.*

The failure to impose a strong national fiduciary duty is costing the American public billions of dollars. As the group SaveOurRetirement.com has noted: "Every single day that passes without a strong fiduciary duty means between $57 million and $117 million of retirement savers' hard-earned money is lost due to conflicted investment advice, amounting to at least $21 billion annually. These are real financial hardships and they militate against any further delay in the

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http://www.aarp.org/research/topics/economics/info-2014/fiduciary-duty-and-investment-advice---attitudes-of-401-k--and-4.html.

rulemaking process."[5] The current regulatory regime allows brokers to put their own interests above those of their clients. According to a February 2015 report by the Council of Economic Advisers entitled, "The Effects of Conflicted Investment Advice on Retirement Savings," Americans are actually suffering $17 billion in losses annually due to conflicted advice they receive from financial advisors under the existing regulatory system.[6]

It is necessary that this rule proposal be enacted to protect retirement investors. PIABA supports the scope of the proposal to cover all retirement accounts, advice directed towards IRAs and rollovers. Below we will discuss the Best Interest Contract Exemption and why this is necessary to replace the current suitability standard.

Best Interest Contract Exemption

The Best Interest Contract Exemption allows brokers to engage in what would otherwise be prohibited transactions so long as they enter into a contract with retirement investors and agree to certain parameters on the relationship which are intended to protect these investors. PIABA supports the best interest contract exemption. Most importantly, the contract would require brokers to acknowledge their fiduciary status under either ERISA or the Code with respect to any recommendation to a retirement investor to purchase, sell or hold an asset. As discussed above, it is often confusing for investors to fully understand a broker's obligation because of the various regulatory schemes under which financial advisors operate and the confusing titles used. The Best Interest Contract Exemption would eliminate any confusion and make the obligation clear to both the broker and the investor.

PIABA is supportive of the disclosures the exemption requires. Oftentimes, retirement investors are given advice to invest their retirement savings in products that are complex, and that they cannot possibly understand. The brokers will oftentimes tell their customers that there are no fees associated with the investment simply because the customers have not been charged a commission. However, the brokers fail to disclose to their customers the fact that while they may not receive a commission, they are still being compensated by the issuer for selling the

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[5] *See* http://saveourretirement.com/cms/wp-content/uploads/2015/02/DOL-SOR-Letter-Comment-Period-Request-5-8-15.pdf.

[6] *See* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf. "Conflicted advice" refers to
advice given on particular investment products where the financial advisor is compensated in fees and commissions that depend on which investment product the customers buys.

investment. The customers do not understand that there are conflicts of interest impacting the brokers' recommendation that do not align with the customers' interests.

A popular product that is sold in this manner is variable annuities. FINRA has questioned the appropriateness of placing a variable annuity in an IRA, yet brokers regularly recommend that investors purchase annuities in their IRAs, usually because the broker will earn a substantial payment from the annuity company.[7] Brokers defend their recommendations, claiming they are "suitable" for investors because of some benefit the annuity offers, such as a death benefit or future income benefit. Yet, the annuities will often have high internal fees and a substantial penalty if money is withdrawn early.

- *Robert was a 70 year old retired business owner suffering from Parkinson's disease, living in Missouri. From 2005 until 2010, Robert's broker Mitch managed his substantial retirement savings, including Robert's IRA. Mitch recommended that Robert purchase a variable annuity in the amount of $330,000 in his IRA. The broker also sold Robert another variable annuity in the amount of $1,000,000 in his trust account. Mitch failed to explain the fees associated with the annuities, failed to explain how it would be invested in the sub-accounts, and failed to disclose how he would be generously compensated for selling the annuity. Eventually, Robert sought the advice of an investment adviser who explained to Robert what he was invested in. At that point, Robert was unable to cancel these investments without incurring substantial penalties. As a result, his money remained inaccessible. Unfortunately, at that point, it was too late to undo the damage Mitch had done.*

Mitch attempted to justify his recommendations of variable annuities, claiming the investments met FINRA's suitability standard. While it is arguable whether these investments met that standard, under such a standard, it does not matter if there are better or optimal investments available.

PIABA also supports the restrictions on the types of securities that may be sold to investors under this exemption. Brokers often recommend complex securities in customers' retirement

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[7] *See* "Variable Annuities: Beyond the Hard Sell", available at http://www.finra.org/investors/alerts/variable-annuities-beyond-hard-sell, ("Investing in a variable annuity within a tax-deferred account, such as an individual retirement account (IRA) may not be a good idea. Since IRAs are already tax-advantaged, a variable annuity will provide no additional tax savings. It will, however, increase the expense of the IRA, while generating fees and commissions for the broker or salesperson.").

accounts that generate income. Again, brokers attempt to justify the recommendation by ignoring the complexity of the investments and the customers' ability to understand the investments and instead focus on whether there is any colorable claim to be made for arguing whether the investment met the customers' stated investment objectives.

- *One such example is Mabel, a 75 year old retiree living in Florida. She retired in 2006 from a bank, where she had worked for 25 years in an administrative capacity. She met her broker, John, who had a desk at the bank, although he worked for a separate brokerage firm. Mabel rolled her employment retirement plan, almost $280,000, into an IRA with John. Initially, the broker purchased three separate, Class A mutual funds with 90% of Mabel's retirement funds. Within a year, the broker recommended that Mabel sell some of the mutual funds and invest approximately a third of the account in structured securities. When those securities matured, the broker purchased reverse convertible securities. Within only a matter of months, Mabel lost a third of her retirement account. The broker, John, justified the purchases under the suitability rule, ignoring Mabel's lack of understanding of the products.*

The need for income is an important one for a retiree. They have usually lost the ability to earn income and must rely on their investments to generate income to offset the spending down of their savings. When an investor has identified the goal of having their retirement funds provide for their day to day expenses for the rest of their life, they turn to their broker to determine the best way to make that happen. Brokers may overlook the underlying risk to principal inherent in the security and focus instead on the income generated by the investment. Too many times, investors report to our members that there is little or no discussion of the other relevant aspects of the investment such as the liquidity, surrender or penalty charges, and the internal fees. However, the investor may have unforeseen long term care or other medical expenses and require access to his or her retirement funds. This short-sighted focus on income harms the investor in the longer term. Additionally, there is often no discussion of the compensation to the broker, or the brokerage firm's association with the issuer of the security.

PIABA supports the exclusion of specific types of securities within the exemption for several reasons. The exemption would prohibit the sale of non-traded real estate investment trusts ("REITs") and private placements. There have been well publicized problems with investments in non-traded REITs and private placements in recent years, and brokers' recommendations of REITs to retirees have caused significant problems for investors. There have been a number of disciplinary actions against brokerage firms by FINRA related to their sales practices of both REITs and private placements:

- In 2014, FINRA fined Berthel Fisher & Company Financial Services, Inc. and its affiliate, Securities Management & Research, Inc., a combined $775,000 for supervisory deficiencies, including Berthel Fisher's failure to supervise the sale of non-traded REITs.[8]
- In 2012, FINRA ordered David Lerner Associates, Inc. (DLA) to pay approximately $12 million in restitution to affected customers who purchased shares in the Apple REIT Ten, a non-traded $2 billion REIT that DLA sold.[9]
- In early 2015, FINRA ordered Brookville Capital Partners LLC to pay full restitution of more than $1 million to the victims and fined the firm $500,000 for fraud in connection with the sale of a private placement offering called Wilshire Capital Partners Group LLC.[10]
- In 2011, FINRA sanctioned a total of 10 firms and 17 individuals for selling interests in several high-risk private placements, including those issued by Provident Royalties, LLC, Medical Capital Holdings, Inc. and DBSI, Inc., which ultimately failed, causing significant investor losses.[11]

It is important that these products not be sold to unsuspecting retirement investors who believe their money is being invested appropriately and in their best interests.

- *Kristen is 61 years old and lives in Colorado. In 2007, Kristen's husband passed away. She inherited her late husband's retirement account and turned to Robert, a broker, whom she trusted would help her through this difficult time. He invested Kristen's retirement nest egg, which had over $600,000 in assets, in mutual funds which his firm had a relationship with, in a number of non-traded REITs, and into several private placements. In addition to the firm's relationships with the mutual funds, the*

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[8] *See* http://www.finra.org/newsroom/2014/finra-fines-berthel-fisher-and-affiliate-securities-management-research-775000.
[9] *See* http://www.finra.org/newsroom/2012/finra-sanctions-david-lerner-associates-14-million-unfair-practices-sale-apple-reit.
[10] *See* http://www.finra.org/newsroom/2015/finra-sanctions-brookville-capital-partners-15-million-and-bars-president-anthony.
[11] *See* http://www.finra.org/newsroom/2011/finra-sanctions-eight-firms-and-10-individuals-selling-interests-troubled-private and http://www.finra.org/newsroom/2011/finra-sanctions-two-firms-and-seven-individuals-selling-private-placements-without.

brokerage firm was also involved in the offering of at least two of the private placements. Robert never disclosed to Kristen his or his firm's financial incentives in choosing the investments he did. Instead, his supposed focus was on Kristen's investment needs. In 2014, Kristen transferred her account away from the broker; however she is still unable to sell many of the investments because they are illiquid.

- *Al also ended up investing in a non-traded REIT. Al retired after working for 29 years for the City of Redmond Parks Department in Washington. He sought advice from two brokers, Robert and Leslie, trusting that they would properly advise him on his retirement. They convinced him to roll his 401(k), in which he had accumulated over $500,000, into an IRA. Al's wife also transferred her IRA to Bob and Leslie. They recommended that the couple invest their retirement savings into a variety of complex investments, including several private placements and a non-traded REIT. Al and his wife were never told that they could lose money. The risks were never explained to them. They thought their money was safe and that they would receive income from these accounts to support them in their retirement. However, because of the type of investments that brokers Bob and Leslie had chosen, Al and his wife lost $350,000 of their retirement savings.*

As described above, a number of private placements have turned out to be fraudulent, completely wiping out the retirement savings of those who were invested.

- *Dayton is a broker in Kansas. He sold a series of private placements, later discovered to be ponzi schemes, to a number of investors throughout Kansas.*
    - *He recommended that Jerry and Glenda purchase $200,000 of the fraudulent securities in their IRAs. Both were retired, living primarily on social security. The couple had first met the broker in 2004 at a free dinner seminar he hosted. He impressed them with his strong Christian faith.*
    - *Another couple, Wayne and Laraine met Dayton in 2004 at a free lunch seminar. The following year, they attended a free dinner seminar that the broker hosted alongside one of the issuers. Wayne was a retired industrial distributor and Laraine was an executive secretary. They invested $235,000 of their IRA money in the fraudulent private placements.*

- *Ed and Rose met Dayton at a free dinner seminar in 2003. Ed is a retired dentist, working part time as a shuttle driver for a car dealer. Ed and Rose also live primarily on Social Security. The broker invested a total of $140,000 of their IRAs in the fraudulent private placements.*
- *Marvin and Delores met the broker at a free dinner seminar he hosted in 2003. Several years later, in 2007, the broker invested Martin's $25,000 IRA in the fraudulent securities.*

Each of these customers trusted that Dayton was acting in their best interests and managing their retirement money safely. They all lost everything. Both the broker and his firm were highly compensated by the issuer of the fraudulent securities based on the amount of securities they were able to sell. This was a serious conflict of interest which incentivized the broker to recommend the fraudulent securities to his clients without overly scrutinizing the issuers. As a result, the broker justified the potential income the securities produced, and concentrated his clients in these investments, while compensating himself and his firm handsomely at the same time.

The exemption would prohibit other complex products as well. This would protect an unknown number of investors.

- *Nick was 91 years old, living off his savings in an assisted living facility in Missouri. Beginning in 2003, when he was 84 years old, and continuing throughout the financial crisis, his broker purchased a number of Real Estate Mortgage Investment Conduit ("REMIC"), CMOs. At various times, the CMOs represented between 25% and 60% of Nick's IRA. Nick lost over a third of the value of these investments, without ever even understanding what his broker had invested his retirement savings in or the risks involved.*

In addition to complex products, the exemption would prohibit the sale of promissory notes. For a number of investors, promissory notes, while being touted as meeting their retirement income needs, have ended up being scams.

- *Larry is 69 years old, lives in Missouri and suffers from Lou Gehrig's disease or ALS. ALS is a progressive neurodegenerative disease that affects nerve cells in the brain and the spinal cord. Eventually, the ability of the brain to initiate and control muscle movement is lost. In 1998, Larry retired from AT&T and rolled over his retirement* *plan into an IRA. For the next decade, the brokerage firm managed his retirement account conservatively. In 2010, his broker, Jimmy, called Larry and told him he had an investment opportunity for his IRA. He recommended that Larry invest approximately half of his IRA, $100,000, in a promissory note that would pay 10% interest in 60 days. The broker represented the investment as completely safe, with a high return. Larry trusted Jimmy and did as he recommended. However, the promissory note failed and Larry's investment was completely lost – half of Larry's retirement money was now gone. Because the investment required Larry to withdraw money from his IRA, Larry also incurred a significant tax liability, which he could not pay. Larry was left with only $90,000 in his IRA to sustain him through retirement with a debilitating illness.*

- *The broker, Jimmy, also advised other clients to invest their retirement savings in the same promissory notes. When Bonnie retired in 2007, Jimmy recommended she roll over her pension into an IRA, which he would handle. In 2010, Jimmy made the same pitch to Bonnie that he made to Larry, recommending that she withdraw almost all of the money in her IRA and invest it in a promissory note. She followed Jimmy's advice, and withdrew $95,000. She was reassured the money would be returned within 15 days. Like Larry, Bonnie never received the money back, and she also suffered significant tax liabilities. Bonnie is still trying to find part time work, which has been difficult. She had worked seasonally for the IRS, but her unpaid tax liability caused her to be formally reprimanded by the IRS. Additionally, her credit has been affected because of the precarious financial position she was placed in.*

There have been widespread repercussions from the sale of promissory notes that turned out to be ponzi schemes.

- *Bobby was a broker in New York who offered multiple services to his clients, including tax preparation services, investment advice, and other services out of his one-stop shop. Between 2003 and 2005, he recommended that a number of his clients invest in a promissory note that was guaranteed to pay 9% in interest every year. Many agreed, believing that Bobby knew what was best for them, since he knew their full financial picture and had prepared their taxes for many years. Here are examples of* *just some of the investors who took Bobby's advice and decided to invest in this particular promissory note:*

- *Robert and his wife, both retirees, invested their life savings, including $160,000 from Robert's 401(k). Irene invested her 401(k), valued at $24,000. Steve invested the full proceeds of his 401(k), rolling over $95,000. Connie rolled over her 401(k) valued at almost $200,000. Larry invested his 401(k), worth over $75,000. Erin invested the $70,000 from her 401(k). Several clients cashed out their pension plans and invested them in the promissory notes. Johanna invested the entire proceeds of her pension plan. Mary invested just under a million dollars, representing a pension earned over a life time working. Edda, also retired, invested over $300,000 from the proceeds of her pension. Bobby also recommended the investment for IRAs. He recommended it to John, aged 74, who invested over $200,000 from his IRA in the promissory note. Cora, 75 years old, invested over $250,000 of her IRA in the investment. Erin invested $50,000 from her IRA in the promissory note. In the end, it turned out the investment was a ponzi scheme.*

Each person who invested lost everything. Their entire retirement savings were gone with a single investment.

With the exception of variable annuities, each of the investments outlined above would not have been permitted under the proposed Best Interest Contract Exemption. These retirement investors would have been protected if the exemption were in place.

When it comes to fighting investor claims in arbitration, brokerage firms consistently maintain that they have no obligation whatsoever to uphold anything resembling a fiduciary duty. "Suitability," as defined by FINRA, is simply not the same as a fiduciary duty, as commonly defined under the law. When discussing the suitability rule, FINRA itself states: "The requirement that a broker's recommendation must be consistent with the customer's best interests does not obligate a broker to recommend the 'least expensive' security or investment strategy (however 'least expensive' may be quantified), as long as the recommendation is suitable and the broker is not placing his or her interests ahead of the customer's interests."[12]

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[12] *See* FINRA Rule 2111 (Suitability) FAQ, available at http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq.

This is hardly the sort of unambiguous guidance one would want for those handling retirees' life savings. Perhaps the clearest evidence that a fiduciary duty places a stronger obligation upon a broker is found when investors file claims in arbitration and the industry unwaveringly denies the existence of a fiduciary duty.[13] If the suitability and fiduciary standards imposed roughly the same duties, then brokerage firms would not so strenuously deny in arbitration that a fiduciary duty exists. A clear contract which specifies what the broker's duties are would better protect investors than the current standard, and would hold brokers accountable when something does go wrong.

To prevent the issues outlined above with respect to variable annuities, PIABA urges the removal of variable annuities from the list of permissible investments available under the Best Interest Contract Exemption. There are inherent conflicts of interests associated with variable annuities and, as FINRA itself has pointed out, a lack of a clear benefit derived from owning most forms of a variable annuity within an IRA.

PIABA believes it is also important that the rule cover all retirement advice regardless of how it is given, even when on a one time basis. Occasionally, retirement investors will handle their own accounts through discount brokerage firms, but still seek advice through the firm's telephone representatives. When those representatives give investment advice, they should be held to a fiduciary standard.

- *Philip, a retiree in Texas, had his IRA with an online brokerage firm. He received a lump sum retirement distribution, and rolled it into his IRA. He sought advice about what to do with the money once it was in his account. In early February 2008, Patrick, a phone representative with the brokerage firm, advised Philip to invest the money, $1.1 million, in an auction rate security, because it was a safe, liquid investment. Unfortunately, at that time, the auction rate securities market had begun to have problems, which was well known. A week later, the auction markets froze and Philip lost access to his retirement savings. Two years later, Philip was still*

[13] *See* PIABA's March 25, 2015 Report, "Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty," available at https://piaba.org/piaba-newsroom/report-major-investorlosses-due-conflicted-advice-brokerage-industry-advertising-cre. PIABA's report gave multiple examples of actual Answers filed in FINRA arbitrations with customers in which broker-dealers denied having a fiduciary duty, and even included one Answer that included an Affirmative Defense that the firm's duties to Claimants were limited to "transactional duties." In other words, the broker-dealer disavowed liability because it was only an order taker doing what the customer wanted.

trying to access his money. Unfortunately, the telephone representative did not owe Philip any duty to give him advice that would be in his best interests.

It is important that the exemption takes the form of an enforceable contract and that the broker's obligation is clearly spelled out in the contract. Prior to this rulemaking, brokers often placed clauses in their contracts which required IRA investors to disclaim that they were relying on the advice they received from their brokers when investing. Although the brokers were making recommendations to buy, sell or hold investments, and the investors were coming to the brokers specifically for that advice, the brokers disclaimed any liability for the advice they gave because of the contracts they had the clients sign.

When clients sued their brokers in FINRA arbitration for poor investment advice, brokers would point to the contracts to demonstrate that the investors agreed that they were not relying on the brokers' advice. Moreover, brokerage firms regularly argue that there is no private right of action for a violation of the FINRA suitability rule, claiming investors have no right of recovery even if their brokers gave bad advice. Further, in those states where brokers are already deemed fiduciary under state common law, brokers regularly disclaim such obligations when investors seek to hold them to such standards in arbitration and, as discussed above, claim that the highest standard they can be held to is the suitability standard.

A written contract will eliminate any ambiguity as to the brokers' obligations to their customers. Moreover, the warranty to comply with all federal and state law regarding the rendering of investment advice will prevent a broker from disclaiming any state law that would apply. PIABA also supports the ban on exculpatory provisions that would disclaim or otherwise limit liability for a broker's actions.

The Best Interest Contract Exemption permits the inclusion of mandatory arbitration clauses in the contracts. While PIABA does not support this section of the rule proposal, PIABA recognizes that brokerage firms will continue to be permitted to include such clauses in their other brokerage account agreements with customers. PIABA believes that all mandatory arbitration clauses should be prohibited, but prefers that such an approach not be piecemeal. PIABA does support the ban on class action waivers.

Fiduciary Duty Carve-Outs for Investor Education Information

PIABA has some concerns about the carve-out to fiduciary investment advice for investor education information. While it is important that retirement investors receive adequate investor education to make informed decisions about their retirements, to the extent the investor education information is provided by a broker during a free lunch or free dinner seminar or is provided on the premises of an employer, the carve-out is problematic. For years, NASAA, the SEC and FINRA have discussed concerns with free lunch and free dinner seminars. As discussed above, broker Dayton met each of his clients at either a free dinner or free lunch seminar. With respect to rollover advice, brokers often make their introductions to their future clients at "educational" seminars held on the premises of the companies. They then follow up with their prospects, giving them investment advice at the next meeting. However, the seminar has already primed these prospects for the broker's advice – to either retire early and cash out their pension or to rollover their 401(k) to an IRA handled by the broker.

- *Veit and his wife, Karen, live in California. In 1994, Veit decided to retire early from Pacific Bell when his job was relocated. Veit attended a seminar held on Pacific Bell's premises by a broker, Marilyn. Following that seminar, Marilyn convinced Veit to take a lump sum distribution rather than the pension, and invest the money with her. She also convinced him to roll over his 401(k) into an IRA which she would then manage. She placed all of the money into a variable annuity. Four years later, Karen, was faced with a similar choice, and once again, the broker convinced her to take a lump sum distribution and invest the money with her. Again, Marilyn convinced Karen to also roll over her 401(k) into an IRA which Marilyn would also manage. The broker invested Karen's retirement funds in two variable annuities. The broker set up each of the variable annuities with monthly distributions and led the couple to believe they would receive income for life. The advice to retire early and invest in the variable annuities was riddled with conflicts of interest that were never disclosed – that the annuities were issued by a company affiliated the brokerage firm; that Marilyn received a large commission for selling the annuities; and that the couple would have received greater income by taking the pensions rather than the lump sum distributions. By 2006, Veit's account was completely depleted. By 2007, Karen's accounts were completely depleted. By 2011, the couple was bankrupt.*

- *Another broker, Sharon, met with a number of Pacific Bell employees in California who were offered early retirement. Each employee was offered the option of a defined benefit pension or a lump sum payout. Two of the employees, Adela and Lauro, first attended seminars given by the broker on Pacific Bell premises, and then met with the broker at their homes. The other employees, Karrell, William, Connie* *and Philip all met with the broker at their homes as well. Sharon told each one the same thing – if they took the lump sum and invested with her, they would be able to take money each month for the rest of their lives, and there would be money to leave to their children or their estates. In addition to investing the lump sum distributions, Adela, Karrell, William and Connie each rolled over their 401(k)s to Sharon as well. Sharon invested all of their money into variable annuities. The advice Sharon gave each investor was conflicted – if the employees did not retire or if they chose to take a pension rather than the lump sum pay-out, the broker would not be paid. She did not disclose these conflicts nor did she disclose the risks inherent in the course she recommended – the costs involved in the variable annuities; that the withdrawals she advised each investor they could take would likely deplete the accounts and would not be able to sustain their retirements; or that the principal of each account was at risk.*

If these investment seminars were not permitted, the brokers would not have established the relationships which lead to conflicted advice. These types of seminars are even more dangerous than free lunch or free dinner seminars because the investors are not receiving an invitation in the mail from a stranger. They are being invited to the seminar by their employers, in the breakroom or the company auditorium. They believe the broker has been vetted by their employer, is acting on behalf of their employer or has come at the invitation of their employer. They don't understand they are walking into a sales pitch. They begin the relationship with a level of trust that would not otherwise exist. When the broker is going over their options during the seminar and explaining all of the ways to invest their retirement money, the broker doesn't explain that if they leave their money in the pension, the broker will not earn a commission. The broker doesn't explain that the only way he or she makes any money is when an account is opened and the 401(k) is rolled over into an IRA. The broker only talks about all of the ways an investor can earn money through various investments that it just so happens that his or her firm sells. These sales pitches should not be permitted under the rule and should explicitly be excluded from the carve-out for investment education information.

Biased investor education may take other forms as well:

- *William was a water technician for the Johnson County Water District in Kansas. After he retired, he invested his 457 Retirement Plan in an annuity. After hearing a broker, Dean, on his Saturday morning talk radio show discussing retirement, Will requested a copy of a book discussed on the show. At that point the broker started* *an intense sales effort to convince Will to sell his annuity and roll over his IRA to the broker so that he could manage it. Dean said he would invest the money so that it would grow by at least 6% each year. Eventually Will did. Dean rolled Will's money into a variable annuity, yet failed to disclose the many conflicts of interest he had. He failed to explain that by investing in a new variable annuity, Will was incurring new surrender penalties. Yet, had Will left the money where it was, Dean would not have earned any commission. Will now works part time for the Kansas Department of Transportation because of the losses he suffered as a result of his broker's investment advice, which Will thought was in his best interests.*

Whenever investment education information is tied to a sales pitch or followed by a recommendation by a broker, it should be covered by the definition of fiduciary investment advice.

<u>Principal Transactions in Certain Debt Securities</u>

PIABA support the exemption for principal transactions in certain debt securities. PIABA also supports the disclosure the proposal requires. Investors do not currently receive adequate information about debt securities. FINRA recently issued a regulatory notice seeking comment on additional disclosures it proposes to require on fixed income securities. There have been a number of disciplinary actions against firms by FINRA over the last few years concerning excessive markups and markdowns of debt instruments:

- *In 2012, FINRA fined Citi International Financial Services LLC $600,000 and ordered more than $648,000 in restitution and interest to more than 3,600 customers for charging excessive markups and markdowns on corporate and agency bond transactions.*[14]
- *In 2013, FINRA fined StateTrust Investments, Inc. over $1 million for charging excessive markups and markdowns in corporate bond transactions and ordered the firm to pay more than $353,000 in restitution and interest to customers who received*

[14] *See* http://www.finra.org/newsroom/newsreleases/2012/p125821.

unfair prices. FINRA found that 85 of the transactions, in particular, operated as a fraud or deceit upon the customers.[15]

- *Also in 2013, FINRA fined Morgan Stanley Smith Barney LLC and Morgan Stanley & Co. LLC $1 million and ordered $188,000 in restitution plus interest for failing to provide best execution in certain customer transactions involving corporate and agency bonds, and failing to provide a fair and reasonable price in certain customer transactions involving municipal bonds.*[16]

It is important that there be transparency in the bond markets where so little information is available to investors.

Ensuring Good Advice for Retirement Investors

Since this rule proposal was released, the brokerage industry has engaged in a campaign of fear mongering, forecasting that advice and services will not be available for small accounts if brokers are held to a fiduciary standard. Not only is there no support for such a statement, the evidence supports a contrary conclusion.

In 2013, the overwhelming majority of participants in the fi360-ThinkAdvisor Fiduciary Survey said that extending a fiduciary standard to brokers "would not price investors out of the market for advice" and that "operating at a higher standard can save clients money over the longterm."[17] Both academic researchers and the SEC have also concluded that investors' access to financial advisors and products will not be affected by a fiduciary duty rule.

A 2012 study conducted by Michael Finke, Ph.D. and Thomas Langdon considered the availability of brokers and financial products in states that maintain strong fiduciary duties, limited fiduciary duties, and no fiduciary duties and found: "A sample of advisers in states that have either a strict fiduciary standard or no fiduciary standard are asked whether they are constrained in their ability to recommend products or serve lower-wealth clients. We find no statistical differences between the two groups in the percentage of lower-income and high-wealth clients,

[15] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P288973.
[16] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P317817.
[17] *See*, Findings of the 2013 fi360-ThinkAdvisor Fiduciary Survey, supra note 4. Specifically, 83 % of the fee only, 72% of the fee/commission, and 66.67% of the commission-only respondents agreed that a fiduciary standard would not price investors out of the market for advice.

the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance."[18]

Likewise, the SEC found that, even if a fiduciary standard was adopted for brokers, retail investors should "continue to have access to the various fee structures, account options, and types of advice that investment advisers and broker-dealers provide."[19] The SEC considered the issue of whether a fiduciary standard would likely limit investors' access to advice and products and found that it could make the recommendation and still "assure that retail investors continue to have access to various investment products and choice among compensation schemes to pay for advice."[20] The brokerage industry has demonstrated that it can find a way to comply with needed investor protection rules and also continue dealing with customers of all sizes. The costs of compliance associated with a fiduciary duty standard are not meaningfully different from those associated with a mere suitability rule. The Finke and Langdon study addressed this issue and found that there is no statistically significant increase in compliance costs in states in which there is a clear fiduciary standard and ones in which there is no fiduciary standard.[21] Furthermore, the SEC's study found that it was possible for it to engage in rulemaking on the subject while minimizing cost and disruption.[22] The impact, if any, will be felt by those firm designed to promote their own interests by offering a small menu of high-cost options to investors.

The Consumer Federation of America found: "While firms of all sizes will have to adjust their business practices to comply with the rule, there is no valid basis for the claim that small firms would be put out of business. For small firms, the key to compliance will be the initial selection of the product menu they offer to retirement savers to ensure that it comports with a best interest standard. Firms that already offer a mix of reasonably priced, high-quality investment options that allows for creation of a diversified portfolio should see relatively little impact from the rule. They would have to enter into a contract with clients, make best interest

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[18] *See* Michael Finke and Thomas P. Langdon, "The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice," March 9, 2012, available at https://www.onefpa.org/journal/Pages/The%20Impact%20of%20the%20Broker-Dealer%20Fiduciary%20Standard%20on%20Financial%20Advice.aspx.

[19] *See* "Staff Study Recommending a Uniform Fiduciary Standard for Conduct for Broker-Dealers and Investment
Advisers," 2011, available at https://www.sec.gov/news/press/2011/2011-20.htm.

[20] *Id.*

[21] *See* Finke and Langdon, supra note 18.

[22] *See* "Staff Study Recommending a Uniform Fiduciary Standard for Conduct for Broker-Dealers and Investment
Advisers," supra note 19.

recommendations, and provide disclosures with regard to costs and conflicts, but their business could otherwise continue largely unchanged. Those whose business is built around the sale of a few high-cost, low-quality products will face a more significant change to come into compliance, but that is appropriate. Either the sponsors of the investment products they recommend will have to adjust their products to make them more competitive under a best interest standard, or the firm will have to consider changing its product mix or, in the case of high-cost products, rebating fees that don't meet the reasonableness standard. While firms are likely to see some increase in compliance cost, including the cost associated with new disclosures, investment advisers who serve the small saver market under a fiduciary standard have shown that it is possible to serve this market affordably."[23]

Conclusion

PIABA thanks the Department of Labor for the opportunity to comment on this important rulemaking. We are hopeful that this opportunity to protect investors will not pass without action. If we can offer any further information, please feel free to contact us.

Very truly yours,

Joseph C. Peiffer

Joseph C. Peiffer
PIABA, President

[23] *See* "DOL Delivers on its Promise: Conflict of Interest Rule Proposal Provides Needed Protections for Retirement Savers, Flexibility for Financial Firms," available at http://www.consumerfed.org/pdfs/150507_DOL-revisedrule_QandA.pdf.